MICROCREDIT GOVERNANCE

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Microcredit Governance

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INTRODUCTION

The lack of client analysis and poor governance tended to weigh down capacities of government-sponsored microcredit program to reach target beneficiaries and to deliver the desired outcomes. As an option for resolving a program implementation dilemma, the study is geared towards carving out sound governance strategies for implementing government-sponsored, pro-poor and market-driven microcredit program.

The Enterprise Development Credit (EDC) sub-component of the Western Mindanao Community Initiatives Project (WMCIP) is a credit program intended for the poor and vulnerable beneficiaries. It is funded by the International Fund for Agricultural Development (IFAD) and is based on the cooperative credit program of the Land Bank of the Philippines (LBP), which is also designated by IFAD as the sole executing agency for EDC. However, the pro-poor credit program cannot be implemented due to perceived inappropriateness of program design and lack of administrative capacity of implementing partners.

Using the good governance model, this study examines the EDC sub-component of WMCIP with the end in view of making it more effective and responsive to the needs of the target beneficiaries while ensuring its financial viability and sustainability.

Currently, however, a large body of literature on governance focuses more heavily on the role of the state in development. Little effort, if any, has been directed towards the applicability of governance principles at the operative level outside government instrumentalities and lifted from civil society perspectives. Central to this study is an attempt to integrate good governance principles to pro-poor microcredit strategies which are profitably carried out by service-oriented credit-granting civil society organizations.

Two world summits in 1997 and 2002 sponsored by the United Nations (UN) celebrated the success of microcredit as a tool for the eradication of global poverty. Microcredit has deviated from traditional credit paradigms and provided an innovative banking model with extensive

outreach towards the poor and disadvantaged communities both in urban and rural areas. Although evaluation after evaluation proved that most institutions providing microcredit services are kept financially viable and helped by donor and government funds, worldwide experience shows that microcredit has improved the financial conditions of an increasing number of poor households by the millions.

On the other hand, good governance is defined as the exercise of political, economic and administrative authority to manage a nation's affairs (UNDP 1997). Poverty alleviation is one of the major affairs of the Philippine government. According to Bautista (2002), governance is one aspect of poverty alleviation that affects the different phases of program components—situation analysis, planning, implementation, monitoring/evaluation. Hence, good governance is necessary in designing and implementing microcredit program as a tool for poverty alleviation.

Different scholars argue that good governance is crucial for an effective and efficient delivery of public

services. It catalyzes the participation of different stakeholders and market players in microcredit programs; enables convenient access to information, openness and transparency of motives in the presence of other stakeholders; instills social responsibility, discipline and legal accountability to each other and to the clientele; and builds financially viable local financial intermediaries and sustainable microcredit programs. These provide adequate financial and technical support for the income-generating activities and microentrepreneurial projects of the poor who have been historically excluded from the mainstream commercial banking system.

Governance affects the different dimensions of program administration involving integrated rural development projects and poverty alleviation initiatives (see Bautista 2002 and ADB 2003). Microcredit program as an anti-poverty intervention should include the analysis of situational variables, formulation and design of alternative credit schemes, implementation, monitoring and evaluation of innovative financial intermediation strategies for intended

beneficiaries among disadvantaged sectors in specific geographic pockets of interest.

Situational Analysis: The Western Mindanao Community Initiatives Project

As the main geographic interest of this study, Western Mindanao (Region IX) is the third poorest region in the country (World Bank 2002). Thus, the Philippine government faces the developmental challenge of designing and implementing a comprehensive package of credit and support services for the impoverished groups in agriculture, fishery and rural sectors.

Across the four provinces, 55 percent (12 municipalities) of the 22 municipalities covered by WMCIP belong to the fourth and fifth class categories of municipalities in the Philippines suggesting that these municipalities are the poorest not only in the region but also in the country.

In view of the primary function of the state to alleviate poverty and to protect and assist the poor and vulnerable, the Philippine government launched WMCIP. It is a special project of the Department of Agrarian Reform (DAR) that aims for the local socio-economic development of 16,000 poor and vulnerable beneficiary-households in at least 80 selected communities in Region IX.

The development goals of WMCIP are: (1) to provide self-employment and income-generating activities to farming and fishing households; (2) to increase subsistence in cash crop and fishery production; and (3) to increase the income by increasing farm and fishery production. The attainment of these goals largely depends on governance processes involved in managing a network of partner organizations from the national government agencies down to cooperatives and people's organizations (POs).

The WMCIP is administered through an Inter-Departmental Steering Committee at the national level composed of Secretary or Director-level officials of DAR,

Department of Environment and Natural Resources (DENR), Department of Agriculture (DA), National Economic Development Authority (NEDA), Department of Finance (DOF), Department of Budget and Management (DBM), LBP and the Southern Philippines Council for Peace and Development (SPCPD). Similar sub-committees are also present at the regional, provincial, municipal and barangay levels. That is, all activities are executed in partnership with local government units (LGUs) and other government instrumentalities; sub-contracted to non-government organizations (NGOs) via competitive tendering; and channeled through cooperatives and POs.

WMCIP is managed by the Project Executive (PE)—an eight-man management team chaired by a Project Manager (PM) based in the Project Management Office (PMO) in Zamboanga City. The PE is responsible for the implementation and supervision of all activities in three Site Operations Units (SOUs)[1] and manages contact with

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[1] represents the three provinces of Basilan (B), Zamboanga del Norte (ZDN) and Zamboanga del Sur (ZDS). Zamboanga Sibugay (ZB), which was included as the fourth province in the study, remains under ZDS-SOU because it was carved out of ZDS when WMCIP was already fully operational,

Provincial, Municipal and Barangay Liaison Committees, and planning bodies. Other PE members include one Financial Controller/Administrator; three specialists—Community and Development Supervisor (CDS), Natural Resource Specialist (NRS) and Credit and Enterprise Development Adviser (CEDA); and three Site Operations Unit Managers (SOUMs).

The supporting staff to the PE comprises the financial and administrative cadres in the PMO and SOUs; and various technical staff at SOUs. Together, they encompass, arrange, and direct all the managerial, coordinating and support inputs required for efficient implementation, whether contracted or undertaken directly.

The project operates through four components:

1. Community and Institution Development (CID) - covers 80 local communities and their associated NGOs and POs, barangays and municipality LGUs, and line agencies with the capability to

plan, prepare, finance and manage development activities and enterprises.

It has three sub-components: (a) Community and Organizational Development (COD) which is expected to enable 80 functional and cohesive community organizations able to implement locally-conceived programs and plans; (b) LGU Capacity Development (LGUCD) which is expected to enable and improve the planning, coordination and implementation capability at 21 municipalities and 80 barangay LGUs; and (c) Line Agencies Processes Support (LAPS) which is expected to enable effective procedures for support to community organizations by three DAR and three DENR provincial offices and the DA regional office and departments.

2. <u>Resource Management (RM)</u> - covers developing technically and financially sound, and ecologically sensitive production systems benefiting about

1,650 coastal and 4,200 upland and indigenous families, backed up by infrastructure improvement and communal resource responsibility and management, reversing the degradation caused by present imprudent or exploitative use.

It has the three sub-components: (a) Land Resource Management (LRM) which is expected to enable the beneficiaries' adoption of proven new crop options and farming systems distributed by extension service; (b) Marine/Water Resource Management (MWRM) which is expected to enable the beneficiaries' adoption of proven new fishery enterprise options for distribution by extension services; and (c) Infrastructure and Resource Enhancement (IRE) which is expected install improved infrastructure or resource management in 80 communities.

3. <u>Small Enterprise Development and Credit (SEDC)</u> - covers expanded and new individual and group entrepreneurs as well as small enterprises based

on farm, fishery and related activities. It involves 1,600 households, with the requisite supporting credit funds for all Project purposes, totaling 36,000 available and accessible loans.

It has two sub-components: (a) Business Advisory Services (BAS) which is expected to enable effective government and private advisory research and counseling services for owners or operators of on-farm and off-farm enterprises; and (b) Enterprise Development and Credit (EDC) which is expected to enable viable and accessible credit services and to provide 36,000 loans for small businesses or microenterprises.

4. Project Implementation (PI) - covers project management and implementation capability for both the immediate tasks of implementation and to demonstrate innovative and cost-effective approaches to the dilemma of financial stringency

and resource scarcity in local development planning and execution.

It has two sub-components: (a) Services and Resource Provision (SRP) which is expected to enable responsive, cost-effective and timely delivery of Project services; and (b) Project Executive (PE) which is expected to enable efficient management and ensure achievement of Project targets.

The EDC sub-component of SEDC is executed by LBP. This credit program is intended for the expanded and new individual entrepreneur and group small enterprises based on farm, fishery and related activities, with requisite supporting credit funds for all project purposes.

Under the original financing agreement between IFAD and the Government of the Philippines (GOP), the implementation strategy of the EDC sub-component involves five layers of financial intermediation processes. Each layer

consists of financial intermediation and re-lending processes and procedures from IFAD down to individual beneficiaries:

1. *IFAD to GOP-DOF*. The first layer covers a loan granted by IFAD to GOP through the Department of Finance (GOP-DOF) at 0.75 percent interest rate per annum, payable in 30 years with five years grace period.

2. *GOP-DOF to LBP*. The second layer includes GOP-DOF's re-lending of the funds to LBP at 4.75 percent per annum.

3. *LBP to LCCs*. The third layer consists of LBP's re-lending of the credit funds to LCCs at 6.75 percent per annum. The LCCs are wholesale credit providers such as the government-owned People's Credit and Finance Corporation (PCFC) and Quedan Rural and Credit Guarantee Corporation (QUEDANCOR) and other credit-granting NGOs such as Mindanao Alliance for Self-Help Societies (MASS-SPEC) and the Philippine

Development Assistance Program-Peoples Sustainable Development Cooperative (PDAP-PSDC).

4. *LCCs to LPCIs.* The fourth layer covers LCCs' re-lending of the credit funds to LPCIs such as rural banks and other small banks, cooperatives, NGOs and POs. The interest rate charged by LCCs to its LPCI-borrowers usually range from 12 to 18 percent per annum.

5. *LPCIs to WMCIP Beneficiaries*. The fifth and final layer covers the LPCI's re-lending of the credit funds to WMCIP beneficiaries or the target end-borrowers. The interest rates charged by rural banks, NGOs, cooperatives and POs usually range from 18 to 60 percent per annum.

The EDC aims to provide viable and accessible credit services of at least 36,000 loans for small businesses. However, it remains unimplemented. Contrary to the target loan releases, LBP has not released a single loan under

WMCIP's EDC sub-component. According to the 2002 IFAD-DAR evaluation, there are 3 reasons why this is so:

1. The EDC sub-component may not be implementable given its implementation design.

2. Reluctance of the pre-identified LCCs to participate in the credit program; and

3. Stringent lending policies. Interested target borrowers are not qualified under existing lending criteria enforced by LBP.

The review of documents and discussions with cooperative officers, NGO field personnel and the Credit and Enterprise Development Officers (CEDOs) revealed that LBP lending program is open to all qualified cooperatives. The main pre-condition for access to LBP credit facility is that each applicant-cooperative must meet all 6 minimum requirements for accreditation as follows:

1.) PhP30,000.00 paid-up capital;

2.) Membership base of 60;

3.) Savings mobilization of PhP500.00 per member per year;

4.) Three-year profitable track record in credit operations;

5.) With written policies, systems, procedures, and short/long-term plans; and

6.) Other selected financial viability requirements (e.g., 95 percent repayment rate, no past due and no history of default in the last 2 years, no bouncing checks, and satisfactory external audit report for the previous financial year).

In view of the above criteria, however, only three WMCIP-assisted cooperatives are fully qualified to avail of LBP's credit program. That is, even without the WMCIP-LBP credit program, the three cooperatives can avail of any loan from LBP under its lending program for cooperatives. However, cooperative officers are reluctant to avail of LBP credit services.

On the other hand, other WMCIP-assisted cooperatives have repayment problems with LBP. The POs lack the required three-year track record in credit operations and could not raise the required minimum capitalization. The PO officers were unable to start savings mobilization among members. Moreover, LBP requires that the POs be converted into cooperatives first before they can access LBP credit services.

The 2002 IFAD-DAR evaluation team notes that despite current efforts, credit will still not be accessible to the poorest. Outreach to the poorest remains constrained by geographic isolation, refusal to participate in meetings, seminars and other barangay affairs. They are shy and they fear that no one will listen to them. In rare instances where they attend meetings, they hardly voice out their opinions. The illiterate and the poorest are further constrained by their inability to understand the Filipino language or Cebuano dialect normally used during meetings and seminars.

The less poor beneficiaries who are interested to avail of credit could not meet the minimum requirements for access to LBP services. There is also inadequate emphasis on mobilization of savings and credit groups consisting of the poorest households. The activities of WMCIP are channeled through cooperatives and POs but the poorest and most vulnerable households are usually not members of any PO or cooperative. This situation further constrains the overall EDC outreach to the poorest and most vulnerable target beneficiaries.

The 2002 IFAD-DAR Evaluation Team further observes that credit alone will not also help in improving the plight of these households. Alternative mechanisms will have to be developed to ensure that frugality is inculcated into the minds of the poorest people more as part of tracking the functioning and discipline of the group, infusion of capital in the form of equity support, support to develop group-based financial management systems and delivery of services for the improvement of livelihood systems. Hence,

a careful redesigning of WMCIP's EDC sub-component is deemed necessary.

2

GLOBAL MOVEMENT FOR POVERTY REDUCTION THRU MICROCREDIT

Poverty is defined as a person's inability to provide for his/her own basic food and non-food needs. According to UNDP (2000), more than one billion people are poor and they live on an income falling below one-dollar a day. Efforts for eradicating or reducing global poverty are spearheaded by the United Nations (UN) system encompassing various interventions to increase per capita income above one-dollar a day or above the poverty threshold defined on a country-to-country basis.

Providing microcredit and other forms of financial services to the poor is one of the many interventions for poverty reduction in developing countries. The UN General Assembly (1997) notes that, in many countries (especially Bangladesh, Indonesia and Bolivia) microcredit programs proved to be an effective tool in freeing people from poverty and helped to increase their participation in the economic and political processes of society. According to World Bank (1998:1), providing the poor with financial services increases their income and productivity, thereby reducing poverty.

Microcredit—also called "microfinance" and "microlending"—means providing small working capital loans to the self-employed poor. Even small amounts of capital—typically $50 to $300[2]—can make a difference between absolute poverty and a thriving little business generating enough income to feed the family, send kids to school, and build decent housing (Swider 2001). The most widely used microcredit strategy for poverty reduction is the Grameen banking model which originated in Bangladesh.

Microcredit is by and large, interpreted as microfinance by practitioners (Rengarajan 2001:3). Microcredit are small loans provided to poor clients by microfinance institutions (MFIs) such as rural banks, credit cooperatives, credit-granting NGOs and other banks. A common characteristic of the microfinance or microcredit institutions' type of clientele is their exclusion from the traditional banking system because of their perceived credit risks, inability to provide loan collateral and generally, low

[2] Philippine MFIs provide small unsecured loans from PhP1,000 to PhP25,000 per individual borrower.

incomes (Llanto 2001:1-2). Microcredit programs use social mechanisms such as group-based lending to reach the poor and other groups, especially women, who lack access to traditional financial institutions.

The international development agencies usually fund microcredit replication programs in developing countries. The MFIs such as cooperatives, rural banks and NGOs generally provide microcredit services to community and neighborhood-based grassroots organizations such as POs, self-help groups (SHGs) or associations. In turn, they provide unsecured small loans to low-income households and microenterprises. These programs normally go beyond conservative financial intermediation schemes and practices of commercial banks and other commercial credit-granting institutions and private lending companies.

Although microcredit is hardly a panacea for poverty eradication, a large body of literature has clearly established that microcredit can contribute to poverty reduction. Empirical evidence further shows that the socially

disadvantaged and vulnerable groups are capable of owning and managing microcredit-financed projects when catalyzed by a change agent. Thus, microcredit programs have provided new directions in the utilization of credit as a development tool. In the new era of alternative credit programs for the poor, the catalytic and steering functions of the government are widely emphasized, especially in providing incentives for community-level initiatives and in creating an environment where financial services can significantly contribute to the fulfillment of the basic needs of the poor.

Microcredit belongs to a variety of national development interventions supported by international development organizations such as the World Bank, UN and Asian Development Bank (ADB), among others. As an anti-poverty intervention, microcredit is embedded in sustainable integrated area development approaches to rural development. Although there are noteworthy efforts with desirable results, development interventions may produce

unintended consequences indicating a huge waste of scarce government resources and a squandering of foreign aid.

Although the 2005 deadline for the goal of providing microcredit services to 100 million poorest families worldwide is rather quite ambitious, it provides a new road map for many other approaches that failed. Despite the limitations of microcredit models, the 1997 and 2002 World Microcredit Summits have shown ample evidence that microcredit is a significant contributor to the global movement towards poverty eradication through national action and international cooperation.

Microcredit as a Mechanism to Reduce Poverty

Poverty reduction remains as the main challenge of the Philippine government; and it is still largely a rural phenomenon (World Bank 2002:9). In this context, microcredit is considered as an innovative financial

intermediation scheme aimed to reduce incidence of poverty especially in rural areas. Its program design and implementation strategy should be aligned with the impoverished clientele's capacity to pay debts and their need for financial services since they are traditionally excluded from mainstream commercial banking system. They are also prey to usurers, loan sharks and other abusive moneylenders.

The impact of microcredit on household income is well-established in Bangladesh. The study of Pitt and Khandker (1996:vi) on the poor clients of Grameen Bank reveals that program credit has a significant effect on the well-being of poor households and this effect is greater when women are the program participants:

1. Grameen Bank and similar targeted credit programs can "empower" women by increasing their contribution to household consumption expenditure, their hours devoted to production for the market, and the value of their assets;

2. Program credit increases total per capita consumption of the poor and the asset holdings of women; and

3. Group-based credit provided to men can also have beneficial effects, particularly on the schooling and total household expenditure.

The Center for Integrated Rural Development in Asia and the Pacific (CIRDAP 1999:15) notes that action research experiences in the Philippines show that credit has given beneficiaries the opportunity of increasing livelihood through enhanced family income and employment opportunities. Cost-benefit analysis of the income-generating activities (IGAs) of the beneficiaries shows substantial increase in family income.

The study of the beneficiaries of the Center for Agriculture and Rural Development (CARD) shows that for enterprises financed with credit, the productivity of labor is higher that the wage rate and the rate of return is higher than the interest rate charged on the loan. The credit further

contributed to 25 percent increase in household incomes (Hossain and Diaz 1999).

For microcredit to be meaningful and profitable, it should be linked to other forms of support services such as awareness training, skills training, savings mobilization, marketing, gender equality and others. Sufficient amount of credit should be provided at the right time and at the right price and be used for the most profitable productive purposes. Linkages between credit and other inputs and assistance should be ensured (CIRDAP 1999:9).

In view of the above, Satyamurti and Haokip (2002) caution that the positive effects of microcredit on household income may not be true to all beneficiaries and may not be the same under all conditions throughout the year. Thus, even though a family may have a significant income for extended periods, it may also face months of no income, thereby reducing its ability to enter into the type of commitment demanded today by most credit providers. Some people are just too poor, or have incomes that are too

undependable to enter into today's loan transactions. These extremely poor people at the bottom percentiles of those living below the poverty line need safety net programs (e.g., grants and subsidies) that can help them with their basic needs. Some are working to incorporate plans to help recipients graduate to microcredit programs.

The applicability and appropriateness of microcredit programs are generally measured in terms of outreach and viability. That is, microcredit programs will have to continuously enable a large number of the poor and non-bankable groups (outreach) to realize considerable margins of profit (viability) for their efforts and investments in income-generating livelihood activities and microenterprises. Net cash returns from economic activities could be used to satisfy a poor family’s fundamental needs so as to cross the poverty threshold.

Controversies and Current Debates in Microcredit

According to the Food and Agriculture Organization (2000), neither the growth nor the reception of the microcredit movement has been without controversy. Like most development efforts, particularly those that compete for scarce donor funds, there are disagreements over the applicable and appropriate role and vision of microcredit. The three most vociferous debates concern the financial sustainability of MFIs, the social targeting of the poorest of the poor, and impact assessment:

1. ***Financial sustainability*.** There is a concern that some MFIs are dependent on donor subsidies. In the past few years, major donors have imposed time limits on the subsidies that they offer for microcredit programs in the hope that MFIs—whether they be public or private—will eventually achieve financial sustainability. For the World Bank-Consultative Group

to Assist the Poorest (WB-CGAP) recipient organizations, that period is five years.

2. ***Targeting the poorest*.** The second debate currently raging in the microcredit world revolves around social targeting of the poorest. There are some who question whether it is appropriate to lend to poor people who cannot meet normal standards of "bankability", especially with donor funds. The crux of this debate concerns the ability of very poor people to pay back loans and avoid further cycles of impoverishment.

3. ***Impact assessment*.** The third major controversy delves on whether it is necessary to devote resources to measuring changes in the behavior of microcredit borrowers owing to their ability to borrow funds. Impact assessments have become a requirement of most lending programs, and yield a confusing array of results.

While it is clear that the maturation of MFIs reveals an economically viable market among clientele that do not need subsidies to carry out their economic activities, it is also quite evident that microcredit is neither a “one-size-fits-all” formula nor the only solution to all types of poverty and capability problems. The design of microcredit programs must be applicable to local contexts and appropriate to the credit needs and financial capabilities of target beneficiaries. Remenyi (1999:6-7) identifies four groups in the poverty pyramid representing four types of target beneficiaries, as shown in Figure 1:

Figure 1. The Poverty Pyramid

At the apex (first quartile) of the poverty pyramid are the **microenterprise operators**. These persons are distinguished by the fact that they employ others, possibly family members on a part-time basis, to assist them in the conduct of their business. Typically, these microenterprises will be directed at adding value to goods or services that can be described as 'wage-goods'—for example, food, clothing, household items, transport, and health services—produced and sold to the informal sector. In this context, working capital is often critically needed.

The next highest stratum (second quartile) of poor persons is composed of the **self-employed poor**. These individuals are not engaged in subsistence activity but in producing for the market, often on a part-time basis. The self-employed poor need working capital and are fully integrated into the cash economy when working as self-employed persons, even though they may not have given up waged labor or subsistence activity entirely. The MFIs can enable members of the vulnerable and laboring poor to migrate into this higher stratum by funding their involvement

in income-generating activities, many of which will be part-time and home-based self-employment options.

Above the vulnerable poor (third quartile) are the **laboring poor**, whose main source of income is the sale of their labor, either in the marketplace or to themselves in the course of subsistence production. Rural credit programs in the past were essentially targeted at the agricultural activities of this stratum. The MFIs serve the needs of poor and subsistence farmers, but there is a deliberate attempt to concentrate on financing activities that diversify their sources of income beyond staple crop production.

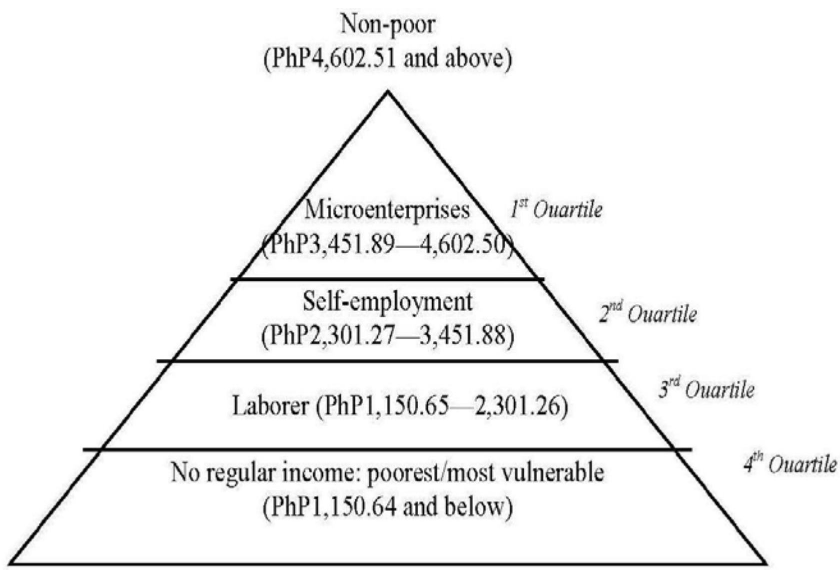
At the bottom of the pyramid (fourth quartile) are the **poorest of the poor; the vulnerable poor**, including pregnant women, old people, children and the infirm. Their vulnerability is directly tied to the fact that the contribution they make to household income is not sufficient for their own survival.

Specifically, the FAO (2000) clarifies that there are different poverty groups requiring different kinds and different doses of anti-poverty interventions at different stages of their dynamic movement out of the poverty trap. The third and fourth groups are critical since a single mistake could lead to disastrous consequences. The third group consists of clients and potential clients for whom subsidized microcredit provides an opportunity to move out of poverty, but at a pace consistent with their income-generation abilities and the economic capacities of their communities.

The fourth group consists of microcredit borrowers who succumb to a cycle of increasing debt, or who face other difficulties in maintaining the demands of financial responsibility imposed by MFIs. For the third group of clients, an excessively swift removal of subsidies would be a mistake; while the fourth group would be better served by other development approaches and tools such as direct food transfers and other social safety net provisions, not microcredit.

Using Remenyi's (1999) poverty pyramid as analytical framework, it shows that the 2000 annual per capita poverty threshold for Region IX amounts to PhP11,046.00 (NEDA 2002). For a family of five, poverty threshold amounts to PhP4,602.50 per month. This means that a poor household with five members earns an average income not exceeding PhP151.32 per day. Shown in Figure 2 is the poverty pyramid in Western Mindanao based on a family of five, the source of income and the estimated average monthly amount generated from it.

Figure 2. Western Mindanao Household Poverty Pyramid



The poverty pyramid enables the identification of the needs and capabilities of the poor and the provision of appropriate and timely doses of assistance. For example, the poorest families who belong to the fourth quartile are likely to have seasonal income, big families, more children and also most vulnerable to illnesses, accidents, loss of income and other economic shocks. That is, income may not be sufficient to support the survival of all household members. For this group, any amount of credit as an anti-poverty intervention will be used for survival (e.g., food and medication); not for capital investment in income-generating activities. Providing microcredit to this group would be a mistake. Hence, social safety nets are more appropriate.

A graduated strategy for microcredit and poverty reduction based on the model used by the Bangladesh Rural Advancement Committee (BRAC) is the more appropriate intervention for heterogeneous poverty conditions. The process of graduation starts from the fourth group where safety nets provisions and capability-building programs for the poorest of the poor or the most vulnerable are provided

until they graduate to the third level. The laboring poor comprise the third group who need a combination of subsidies and microcredit services until they graduate to the second level—the self-employment level; and then to the highest level—the microentrepreneurial level.

The poor and non-bankable ultimately graduate out of microcredit and onto mainstream commercial banking and finance when their economic activities are classified as commercially viable and their projects bankable. At this ultimate stage, it is envisioned that microcredit beneficiaries have already crossed the poverty threshold and their levels of bankability and credit-worthiness have already satisfactorily passed conventional standards required by the mainstream commercial banking system.

Microcredit for Poverty Alleviation: A Critique

Despite the celebrated success of microcredit, critics still point to its flaws and weaknesses. Gina Neff (1996) argues that while the press and the global network of localists rave about the Grameen Bank's lending to "landless" women, the miracle dissolves on closer inspection. For example, Grameen rules insist that its borrowers own their homes—unlike the assumption that shoeless women have bootstraps. Evidently Bangladeshi homeless women do not count as the poorest of the poor. And unfortunately, Grameen borrowers are staying poor. After eight years of borrowing, 55 percent of Grameen households still are not able to meet their basic nutritional needs—so many women are using their loans to buy food rather than invest in business. That is a figure that the press fails to mention. The World Bank, in its 1995 study of Grameen, focused mainly on the bank's financial viability, checking whether the program was breaking even or turning

a profit. Unfortunately, only foreign grants are keeping it afloat.

Gina Neff (1996) further notes that Mohammad Yunus—the founding chairman of Grameen Bank—himself lustily defends his vision of for-profit lending to the poor. In his words, capitalism does not have to be the "handmaiden of the rich"; even poor people can benefit from the system if they are only given the chance to use their innate business savvy. But even though part of his mission is to let lenders graduate into commercial banking, and the World Bank sees lenders' graduation a sign of the program's viability; that is just not happening. According to the World Bank report, " Grameen Bank may have a market niche because its borrowers are dependent on the program, but over the long run this relationship could render Grameen Bank vulnerable. Unless borrowers' graduation from low-level incomes to higher levels (if not from the program entirely) is encouraged or achieved, many members will become permanently dependent on Grameen Bank credit and services." The same study reveals that Grameen had no significant impact

on women's wages in rural villages, although it did boost men's and children's wages. And with all the hype about Grameen's being the largest microlending program in the world, one could never guess that loans to women have remained a mere five percent of the total amount lent in the Bangladeshi countryside since the 1980s.

Successful MFIs like Grameen have been criticized for being too harsh in enforcing social and legal accountability measures. The Bank never forgives a loan, despite natural disasters, and the loan circles result in domineering women pressuring weak women into repayment. Furthermore, there has been doubt expressed that microcredit can have an impact on poverty. A major blow to microfinance came in the form of a report to the UN Secretary General which examined the role of microcredit on the eradication of poverty. The report stated that resources could be put to better use than microcredit in helping rid the world of poverty and implied microcredit was a squandering of aid. The report claimed that microcredit was too experimental and that resources should only be “channeled

to sectors that have potential, especially agriculture, infrastructure and education." The report further stated that in order to succeed, the MFI must be very efficient, have support in the form of training and information disseminated to the poor, government and non-governmental agencies would have to work together, and there would have to be strict regulations on loans. The report implied that satisfying these standards was unlikely to yield desirable results. Therefore, microfinance was a bad prospect for eradicating poverty (Figura 2002:177-180).

Like many other foreign-funded development programs worldwide, the role of microcredit in poverty alleviation and rural development has never been without critics and controversies. The impact of microcredit and other lending programs for the poor produced both positive and negative outcomes. That is, both failures and successes were recorded by concerned international donor agencies. Nevertheless, Outside Grameen Bank, BRAC, Association for Rural Advancement (ASA) and Bank Rakyat Indonesia (BRI) which are considered the world's largest and

most successful MFIs, many microcredit programs have failed. Typical features of failed microcredit programs include endless dependence on government or donor subsidies, high default rates, unsustainable administrative costs, and long delays in the delivery of services (FAO 2000).

On the other hand, while the net long-term effects of microcredit on the quality of life of the poor beneficiaries remain shrouded with controversies, the most successful experiences especially in Bangladesh and Indonesia have provided a wide array of best practices in microcredit. The best practices serve as models that can be modified and replicated in other developing countries. The final choice among successful models largely depends on which model is applicable and appropriate to the needs and capabilities of target beneficiaries and support from the national government and international donors.

3

MICROCREDIT AS AN INSTRUMENT OF GOVERNANCE

The World Bank (1998) argues that poverty is a manifestation of poor governance. Hence, it is also argued that the failure of microcredit programs has been largely due to poor governance. Furthermore, since sound development is synonymous with good governance (Leftwich 1993:605), it is necessary to incorporate good governance principles in the design and implementation of microcredit program to make it an effective and responsive strategy for poverty reduction and rural development.

According to Victoria Bautista (2002:1), governance is one of the aspects of poverty alleviation that needs serious attention because it affects the different phases of the management of program components—situation analysis, planning, implementation, and monitoring/evaluation. Governance innovations can come from two sources: one is direct, if the innovation targets pro-poor program structures and mechanisms; the other is indirect, when innovations are undertaken to improve efficiency and effectiveness of the administrative machinery without necessarily addressing programs and projects that directly target the poor.

Business in the emerging microfinance industry goes through three stages characterized by vision, management and governance. Governance is a system of checks and balances. Governance is sometimes conceived as a virtuous circle that links the shareholder to the board, to the management, to the staff, to the customer, and to the community at large (Otero 2001). The emerging interpretation of governance emphasizes an active participation of citizens as community members, as organizations and as individuals (UN DESSA 1999:3).

Closely linked to the issue of governance is ownership. Understanding what an owner stands to lose clarifies the factors that contribute to effective governance of MFIs. Moreover, clarity of policies and procedures and willingness to engage in critical self-evaluation are the final essential components of effective governance. Thus, the challenge for all MFIs is to emerge with strong and long lasting governance structures that will help assure their long-term sustainability (Otero 2001:6-15). Moreover, the new economists of organization see institutions as governance

structures and social arrangements geared to minimize transaction costs (Powell and Di Maggio 1991).

Thus, in order to make microcredit a meaningful strategy for poverty alleviation and rural development, it necessitates a working framework of good governance that aims to maximize revenues and minimize transaction costs. In this framework, profitability should be maximized while administrative costs (cost of operations) should be minimized.

Wholesale microcredit funds are generally sourced from the international donor community and delivered to target clientele via public service delivery system and in collaboration with the network of civil society and business sector organizations. Institutional partnerships involve the non-government instrumentalities as service providers, consortium members or sub-contractors of the government for the delivery of credit and pertinent support services to target borrowers who have no access to commercial credit facilities.

Microcredit aims to increase income and improve livelihood systems of the poor and disadvantaged groups especially in the agriculture and fishery sectors in the rural areas. In this context, good governance involves the process of managing through the involvement of stakeholders encompassing the economic, political, social and cultural backdrops of microcredit; the administrative capabilities of partner organizations; needs and capabilities of target beneficiaries; and the natural resource base of communities.

Ideally, designing microcredit programs should be highly participative and should involve a series of consultations at the household level to determine the general socio-economic conditions of target clientele, their credit needs and financial capabilities. These are the empirical bases in determining available community resources being used for income-generation and in identifying resources that are not available but are actually needed to increase economic productivity in the agriculture and fishery sectors.

The information from the beneficiaries should be fed to Barangay Development Plans (BDPs) which should then be used as basis for determining the nature and extent of poverty alleviation interventions and other forms of development assistance that will be provided by WMCIP in coordination with partner organizations. In the case of WMCIP's EDC sub-component, the design and implementation strategies should encompass credit-related activities of the beneficiaries and what they can do or must do to help themselves; ongoing self-help and other development activities of grassroots organizations; and the existing LGU and NGO projects in the community. All these development activities can be analyzed using a working framework of good governance covering the principles of participation, transparency, accountability and sustainability.

In the case of participation in credit programs, the beneficiaries should be involved in profit-oriented economic activities such as crop, livestock and poultry production, fishing, aquaculture (fish ponds) and microenteprises such as retail (sari-sari) stores, vending, home-based food

processing and other income-generating or livelihood activities. Otherwise, the target beneficiary is excluded from the credit program but provided with appropriate public services (e.g., social safety nets, farm subsidies, etc.).

On the other hand, the participation of credit-granting civil society organizations is a necessary component in ensuring outreach to isolated and very poor communities. The participation of wholesale credit providers is likewise necessary because the Philippine government (see Executive Order 138, 1998) prohibits the involvement of any non-credit-granting government instrumentality from administering any credit program. Moreover, when ODA funds are involved, only LBP and the Development Bank of the Philippines (DBP) are recognized as government financial intermediaries (GFIs). That is, any other institution wishing to participate in any ODA-funded credit programs should first secure full accreditation from either LBP or DBP.

Transparency, meanwhile, could be analyzed using two levels, the program implementors and the beneficiaries.

All information should be made available and be easily accessible to all stakeholders and program participants. In the case of program implementors, the accreditation of GFIs facilitates the easy and convenient access to vital information on the resources and administrative capabilities of partner organizations. Outside Executive Order 138, however, vital information on partner organizations could not be ascertained especially in the case of sub-contracting public services. This is apparently caused by laxity in enforcing pre-qualification and bidding requirements; or less than three qualified bidders and competitive public service contractors operating in the target communities; or required documents are simply falsified.

At the beneficiary level, credit-related transparency remains limited. In the case of cooperatives and POs, financial records are normally kept confidential by officers while individual beneficiaries do not keep any record at all or they do not simply tell the truth about financial records and related documents.

Formal information exchange and dissemination are limited to the frequency of contact of the beneficiaries with the representatives of concerned organizations and their ability to translate official documents into the dialect. In certain instances, even if the document is translated into the dialect, it is still of no use to some beneficiaries since they could neither read nor write. Hence, the most effective and the fastest means of communication and information exchange are direct interaction and other forms of informal communication.

Furthermore, the accountability of program implementors and beneficiaries remain as the most crucial and most central to microcredit programs. Accountability is measured in terms of the borrowers' ability to pay the loan by virtue of the project's profitability, reputation in the neighborhood and peer pressure. Otherwise, legal measures of enforcing accountability become necessary. The accountability measures are largely dependent on the responsibilities of the credit-granting organizations in enforcing borrower and institutional discipline.

The enforcement of accountability measures in credit programs suggests a series of delegating responsibilities from the top. Since WMCIP's EDC sub-component is a form of business loan from IFAD, its repayment by GOP primarily depends on loan repayment of the end-beneficiaries. That is, if the beneficiaries do not repay their loans, the ripple effect will be evident across all the financial intermediation layers of the EDC. Because EDC is a sovereign loan, the national government will take full responsibility in case of ultimate failure and will eventually pay IFAD the loan that the end-beneficiaries could not repay.

In terms of sustainability, governance could be analyzed in two levels: program sustainability and borrower sustainability. Program sustainability is measured in terms of the net profits generated from the interest earned from credit operations while borrower sustainability is measured in terms of net profits generated from the loan-funded livelihood projects and activities. Ideally, the net profits should be generated in order for the borrower to repay the loan. However, this may not hold true under all conditions.

Loan funds may be utilized for other purposes and still be fully paid by the borrower using other income sources.

Under unsecured microcredit scheme, it is assumed that if the object of financing does not generate sufficient net profits, the borrower cannot repay the loan. In this case, enforcement of accountability measures come into play by enforcing repayment from co-makers of peer-group guarantors. This may strain social relations among neighbors, friends and relatives. In ultimate cases when repayment could no longer be made to the guarantors who assumed the debt, the defaulter will finally be excluded and ejected from the group in the presence of neighbors, relatives and friends within the community. Thus, the enforcement of accountability measures are normally carried out in the presence of representatives of concerned organizations. This makes the whole process transparent and known by the community which may eventually result to social exclusion of defaulters or migration to distant places.

On a positive note, the end-borrowers' full repayment of the loan provides them with access to repeat loans and higher loan sizes. This suggests expansion of the loan-funded projects, increased profitability and increased income. Ultimately, after subtracting operating expenses and loan payments from gross income, the net profits could be used for other household expenditure such as house improvements, children's education, clothing and other requirements beyond the satisfaction of the family's basic needs for survival. The beneficiary's full repayment of the loan will enable the creditors to repay their loans to the government and generate net profits from microcredit. Furthermore, this will enable the government to fully repay its loans to IFAD.

Using the good governance framework in describing the different phases of financial intermediation involved in implementing the EDC sub-component, it is apparent that governance processes are crucial in the design and implementation of the EDC sub-component. That is, all processes and transactions involved in implementing EDC

consist of governance processes. The processes encompass providing appropriate profit-generating environment to encourage the participation of credit wholesalers, retailers and borrowers through loan availments; providing adequate information to all program implementors and maintaining open and transparent communication and information systems; and the continuous cycle of loan availment, repayment and re-availment processes.

The continuity of loan cycles suggests that borrowers are profitable and hence, microcredit program itself is financially viable. Since sustainability is largely determined by full cost recovery plus profitability, this scenario suggests the sustainability of microcredit and the MFIs. In this context, good governance involves the continuous processes of formulating and reformulating program designs and managing and implementing microcredit programs for continuous improvement which could make it more effective and more responsive to the changing needs and capabilities of the clientele.

In reality, however, most MFIs face a difficult task of balancing social and financial objectives; reaching large numbers of low-income microentrepreneurs while generating profits (Rock, Otero and Saltzman 1998:17). This is because providing credit to the poor and non-bankable is costly and quite risky. The possibilities of loan delinquency and default are high and the administrative costs of operations and maintaining credit officers and staff to handle microcredit transactions at the barangay and borrower levels are likewise high.

Hossain and Diaz (1999) in a study of CARD Rural Bank in San Pablo, Laguna reveal that the microcredit operations could only be profitable if the interest rate charged on the loan is at least 60 percent per annum or five percent per month. The CGAP (2003) on the other hand, agrees that it will require at least five years of successful operations to make the program fully profitable. In this case, successful operations means at least 90 percent loan repayment rate so that profits can be generated from the MFI's interest earnings.

Providing credit to the poor and the non-bankable is also considered both as a profit-making business and a social mission. Otero (2001:6) avers that this is largely because commercial banks do not transact business with the poor and the non-bankable. The MFIs fill this gap by devising appropriate and innovative strategies of doing business with the poor who have been historically excluded from conservative banking and mainstream commercial financial intermediation.

Furthermore, MFIs originated with a mission that combines social and financial objectives. The social mission—to provide financial services to as many of the lowest income population as possible—is combined with a financial objective, which is to achieve financial self-sufficiency, enabling sustained service delivery without dependence on subsidies (Otero 2001:6). This largely means that while doing business with the poor MFIs should also generate profits from unsecured loans at a commercial level pegged at the prevailing interest rate on secured (with

collateral) commercial bank loans (e.g., 25 to 30 percent per annum).

In this view, the social mission of MFIs espouses the social equity value premise of New Public Administration (see Frederickson 1971) while the financial viability objectives are well-established in the principles of Entrepreneurial Government (see Osborne and Gaebler 1992). Both social equity and financial viability value orientations are well-founded in the nature and extent of support to microcredit programs provided by the national and local governments and the international donor organizations. Both social equity and financial viability are likewise the twin objectives that should be espoused in applying good governance in the design and implementation strategies of microcredit programs. This working framework is believed to make microcredit effective and responsive to the needs and capabilities of target clientele.

4

SUCCESSFUL MICROCREDIT MODELS

But what is needed for a successful microcredit program? If the conditions for microcredit are in place, then who should do it? Ideally, a strong local microcredit institution, or a bank that is committed to poor clients, or an international microcredit organization are the best choices. Suitable institutions should have a commitment to the four basic tenets of high-quality microcredit (CGAP 2001:3):

1. providing long-term financial services, or *permanence* suggesting at least 10 years of microcredit operations;
2. reaching large numbers of clients, or *scale* suggesting a minimum of one million active borrowers;
3. reaching the poor, or *depth of outreach* starting from the richest among the poor down to the poorest of the poor; and
4. reaching full *financial sustainability* by generating net profits from microcredit operations and without grants and subsidies from donors.

Following the four basic tenets of high-quality microcredit, three of the four most successful microcredit programs are Bangladeshi models—Grameen Bank, BRAC, and Association for Social Advancement (ASA). The fourth is the Indonesian model—Bank Rakyat Indonesia (BRI). The successful microcredit models have gained international recognition in terms of the four criteria of successful microcredit programs. That is, for at least 10 years, they have continuously provided credit services to at least one million active borrowers who are poor while recovering the full cost of operations plus profit, thereby reducing or totally eliminating dependence on donor or government subsidy.

With more than two million active borrowers, the first and the world's most successful microcredit pioneer is Grameen Bank. It started its operations in 1976; has total outstanding loan portfolio worth US$298.8 million; and served 2.06 million active borrowers as of end-1995 (Seibel 1998:2). The ASA entered the industry in 1991; served more than 1.7 million active borrowers; and managed an outstanding loan portfolio worth US$112 million as of end-

1998 (Hatch, Levine and Penn 2002:10). The BRAC started its microcredit operations in 1974; served 2.03 million active borrowers; and managed US$ 108.9 million outstanding loan portfolio as of end-1998 (Zaman 1999:37). The BRI started microcredit in 1984; served 2.6 million active borrowers; and managed an outstanding loan portfolio worth US$1.38 billion as of end-1995 (Seibel 1998:2).

Implementation Strategies of Successful Microcredit Models

Despite the popularity of microcredit—evidenced by two world summits in 1997 and 2002 and the enormous financial support from the international donor community—its principles and mechanisms are geographically limited and culture-bound. The different cases presented below point to one direction—the replicability of microcredit principles are neither universal nor are they "one size-fits all" formulas or "blueprints". Microcredit principles heralded in the clarion call of microcredit fanatics cannot be a panacea for a "cure-

all formula" of the global poverty problem. Its success remains primarily dependent on local contexts, needs and capabilities of target beneficiaries, partner institutions and other stakeholders.

The Grameen Credit-Only Strategy (minimalist approach)

Grameen Bank is the successful pioneer in what we know today as microcredit. The Grameen model is known for its minimalist approach providing only credit through peer-groups composed of five member-borrowers. This model is based on sole microlending practices and a rooted social commitment towards marginalized peoples (De Noose 2001:2). According to Joe Remenyi (1997:2-4), the Grameen 'model' has six key features:

1. Grameen Bank is a licensed bank and as such can present itself as part of the legally recognized network of financial institutions able to access the due processes of the law to protect depositors and its other members;

2. Banking operations are built on ‘peer group’ procedures for client selection, risk management and loan repayment enforcement, based on small groups of not more than five members. These small groups meet regularly and take responsibility for collecting small amounts of money on a frequent schedule;

3. Loans are made almost exclusively to poor women from households that own no farmland or other significant assets;

4. The program is ‘minimalist’, specializing in the delivery of small loans for short durations at a rate of interest that is above the inflation rate and the cost of capital. Client training, deposit and loan repayment collections and participant motivation work is ‘externalized’ onto groups and group leaders. Group formation and group activities are crucial to the Grameen model, but the cost of these is largely borne by the group members themselves. All borrowers must make a commitment to a compulsory saving regime, which acts as a form of loan default insurance program; and

5. All potential clients must make a commitment to the Grameen Bank principles that directly relate to good citizenship, social goals and personal well-being.

Although the Grameen model has been replicated in 45 countries (FAO 2000), not all of the six main features of the Grameen principles are universally applicable and not all principles are appropriate to all poverty conditions. The minimalist approach (credit only strategy) of Grameen automatically excludes the non-enterprising poor thereby pushing them deeper into the poverty trap. Moreover, the advent of natural calamities and inevitable circumstances adversely affecting the borrowers' capability to pay as well as the harsh enforcement of accountability measures pushes the poor further into debts they could no longer repay. This will ultimately result to the defaulting borrowers' migration to distant places where they could no longer be held socially and legally accountable for their indebtedness.

The limitations of the Grameen model resulted in different hybrids and innovations in the light of prevailing

poverty conditions and capabilities. Enabling the poorest and the economically inactive groups to engage in a dynamic interchange with economically active agents requires a comprehensive package of microcredit strategies. These include among others, savings mobilization, provision of support services and a graduated scheme towards proactive climb out of poverty.

Bangladesh Rural Advancement Committee: A Graduated Process for Helping the Poorest

The BRAC went beyond the minimalist approach of Grameen Bank and had set the stage for a graduated scheme of using microcredit as a tool for poverty eradication. Its major programs include credit-based income and employment generation, poultry and livestock, fisheries, sericulture, income generation for vulnerable group development, microenterprise lending assistance, human rights and legal support, and essential health care. The BRAC programs resulted in the improvement of income and living conditions of beneficiaries.

Since 1974, the BRAC model, common to many NGOs that support a microfinance program, shares many of the features of the Grameen Bank model, but it also includes 'social welfare' components in addition to the minimalist microcredit programs. In addition to the Grameen features, there are only two elements unique to the BRAC-NGO model:

1. Microfinance is part of a broader strategy of 'holistic development' that may or may not use the group approach to deliver and regulate the services offered; and

2. Opportunistic tailoring of activities to meet local circumstances and compliment the non-microfinance activities which are designed to help poor households help themselves.

Specifically, BRAC's Income Generation for Vulnerable Groups Development (IGVGD) Program provides a model for a graduation process of helping the poorest of

the poor. It aims to strategically link the food aid with training, savings and credit. Targeted towards destitute rural Bangladeshi women, the program assists participants to move from absolute poverty to economic independence. Over 10 years, nearly a million participants have made that transition. The IGVGD begins with an 18-month commitment of free food (with the support of the World Food Program and the government) to people at greatest immediate risk. The program engages participants in skills-training programs on income-generating activities such as poultry rearing and silk. The IGVGD program also provides the hardcore poor participants with access to BRAC's Essential Health Care services, which addresses the link between productivity and health. During this period, BRAC teaches participants to save, building up an economic "nest-egg" for future investment and protection. Most participants then progress to individual income-earning activities within the same sectors. Within two years of starting the process, roughly 80 percent had made the transition–with their small income-earning activities and accumulated savings–into BRAC's mainstream microfinance program as borrowers.

This progression of support services–from grants to training to savings to self-employment–appears to be sufficient to break down the barriers of extreme poverty, social isolation, lack of productive skills, and poor self-confidence that previously kept this population from self-employment (CGAP 2001:8).

Furthermore, Joe Remenyi (1997:2-4) observes that some of the larger NGOs, such as OXFAM, Save the Children, World Vision, CARE and CONCERN, follow implementation and funding strategies that lend characteristics to their individual programs of microfinance that are genuinely unique. Most NGOs see their involvement in microfinance as a necessary but temporary activity, which they are happy to abandon once the target households graduate into the mainstream financial system.

The comprehensiveness of the BRAC-NGO service delivery system includes a microcredit program for different target groups starting from the poorest of the poor and the most vulnerable up to the non-poor. It combines the delivery

of microcredit and social safety nets simultaneous with capability building measures to develop skills and confidence for a dynamic movement from subsidy dependence towards economic options with positive financial returns. The strategy aims to enable the non-bankable poor to eventually have access to mainstream commercial banking system regularly and sustainably.

The BRAC-NGO model appears to be a comprehensive package of microcredit plus support services intended for the poor and non-poor clientele. Hence, BRAC not only provides microcredit but also a wide array of poverty alleviation and rural development initiatives to different poverty groups and to non-poor groups as well.

Going Beyond the Group Guarantee. A study of the FAO (2000) reveals that MFIs are more flexible in their terms of lending and repayment than many formal institutions, but more structured than informal lenders. All over the world, many variants of microcredit emerged as the geographical reach, clientele and aims of MFIs expanded.

Both in the conditions of lending and in the nature of the borrowers, contemporary microcredit emerged as a hybrid of development tool and financial service.

<u>Bank Rakyat Indonesia’s Character References</u>

The BRI’s successful microcredit program is largely contributed by its reliance on character references and locally recruited lending agents in place of physical collateral. It also operates in a deregulated policy environment and serves a broad low-income market segment with the individual technology (Seibel 1998). Although BRI model share some features of Grameen banking, it successfully introduced innovations beyond the core principles of Grameen.

However, the BRI microcredit scheme is culturally-bound and appears to be unique only under Indonesian context. Hence, BRI’s microcredit strategy is unlikely to be applicable and not appropriate for replication outside Indonesia (CGAP 2001).

Association for Social Advancement and Compulsory Savings Scheme

The ASA uses compulsory member-savings as collateral and hedge against fortuitous events and possible loan defaults. It entered the microfinance industry in 1991 and in the space of a decade has become one of the largest and fastest-growing MFIs in the world with 326,200 active borrowers in 1995. As of end of 1999, the program currently serves more than 1.084 million clients through a network of 1,087 branch offices, has 70,300 village-based client groups, has mobilized $29.7 million in savings, and has an outstanding loan portfolio of $112 million distributed via one-year loans with weekly repayments (Hatch, Penn and Levine 2002:10).

With this kind of critical mass in its favor, in 1998 ASA took the radical step of going beyond the group guarantee requirement, such that its clients no longer have to pay for each other's delinquency or default. In its place, ASA enforces a policy of zero tolerance for arrears and currently enjoys an overall repayment rate of 99 percent. It also allows

its clients fairly unfettered access to their savings (particularly to confront emergencies or seasonal cash needs) without leaving the program and without having to start all over again with entry-level loans (Ibid.).

The ASA model is fast gaining ground among MFIs in the Philippines. It focuses on social action, promoting legal rights, awareness and social justice for the poor. To date, ASA has the following basic features (Manlagñit and Lamberte 2003:32):

1.) Individual lending without peer pressure;
2.) Simple, standardized and cost effective branch structure, with only the branch manager and four loan officers. Having no accountant and other support staff life office assistant and cashier at the branch level;
3.) Simple standardized bookkeeping and accounting operations. Everything is done manually at the branch level;

4.) Simple loan and savings products, also single product service;

5.) High degree of decentralization at the branch level;

6.) Delinquency controlled by sit-down or doorstep technique; zero tolerance;

7.) Fast expansion through cost-minimized operation since a branch becomes sustainable in nine months; and

8.) Formation of homogenous groups for credit repayment and savings.

In view of the unique microcredit features of Grameen, BRAC, BRI and ASA, it is widely perceived that growth in microcredit programs has been phenomenal as shown in Table 2. Successful MFIs have proven that financial services can be an effective and powerful instrument for poverty reduction, helping poor people to increase incomes, build assets, and reduce their vulnerability in times of economic stress (CGAP 2003:1).

Table 2. Highlights of Success Benchmarks for MFIs

Benchmark	Microfinance Institution (MFI)			
	GB	*BRAC*	*ASA*	*BRI*
Permanence (length of operations as of 2003)	27 years (since 1976)	29 years (since 1974)	12 years (since 1991)	19 years (since 1984)
Scale (number of active borrowers)	2.06 million	2.03 million	1.7 million	2.6 million
Depth of outreach (type of clients)	poor	poor	poor	poor
Loan Portfolio	$ 298.8 million (as of 1995)	$ 108.9 million (as of 1998)	$ 112.0 million (as of 1998)	$ 1.38 billion (as of 1995)

Beyond, Grameen Bank, BRAC, ASA and BRI, microcredit experiences worldwide yielded a wide array of results. While microcredit successfully reduced poverty of their clients in some Asian and Latin American countries, the results in other countries are the opposite. The World Bank's Consultative Group to Assist the Poorest (WB-CGAP 2003:1) observes that there is greater consensus than ever before about what is needed to make microfinance sustainable. Yet, with the exception of a few countries such as Bangladesh and Bolivia, microcredit has failed to reach a

massive scale in improving the lives of large numbers of the poor.

Thus, critics and advocates could not reconcile their positions and arguments in the controversies and debates on the role of microcredit in the eradication of poverty. Along the line of argument presented by the WB-CGAP, the only point of convergence is that, the challenges, issues and controversies in microcredit as a tool for poverty reduction will have to be resolved in the next decade, otherwise microcredit will remain an unfulfilled promise.

On the whole, the Center on Integrated Rural Development for Asia and the Pacific (1998:8) concluded that microcredit is more effective when combined with other social interventions. In view of the limitations of Grameen replications, it has been observed that there is a need to look beyond microcredit and deploy a wide portfolio of financial services to meet the diverse financial requirements of the poor and support their coping strategies to reduce vulnerabilities for both income promotion as well as income protection.

5

MICROCREDIT FOR POVERTY ALLEVIATION: THE PHILIPPINE EXPERIENCE

Among the 49 microcredit replicators in the country, only four Grameen Bank Approach Replicators (GBARs) could be considered as having quality microcredit operations based on CGAP's four tenets: (1) the Cooperative Rural Bank of Laguna, Inc. (CRBLI); (2) Center for Agriculture and Rural Development (CARD); (3) Negros Women for Tomorrow Foundation, Inc. (NWTFI); and (4) Tulay sa Pag-unlad, Inc. (TSPI).

Hans Seibel and associates (1997:2) note that some claim that only the rural banks have the potential of truly reaching out to the poor, but would require thorough familiarization with financial technologies of profitable banking with the poor. Some rural and private development banks in Mindanao have successfully demonstrated that banking with the poor is feasible.

Comparatively, the interest rate charged by MFIs is lower than the cost of borrowing under the usual five-six informal credit arrangement prevalent in the Philippines. In the five-six scheme computed on a monthly basis, for

example, the borrower pays a lumpsum amount of PhP600.00 for every PhP500.00 borrowed from the informal moneylender or “loan shark”. This translates to a PhP100.00-cost for borrowing PhP500.00 compounded on a monthly basis. Thus, the cost of borrowed money from the informal credit sector usually runs to a maximum of 20 percent per month or 240 percent per year as compared to the 60 percent annual interest rate charged by cooperatives, MFIs, credit-granting civil society organizations and private commercial banks and lenders.

Successful local experiences and indigenous models of microcredit as a strategy for poverty alleviation in the country still offer some areas for possible improvement. Other avenues and mechanisms still remain to be explored. Some indigenous models proved to have generated positive impact on the living conditions of their clientele and have continuously developed the institutional capacity to respond to the poverty problem of their clientele. Moreover, emphasis for the implementation of a comprehensive microcredit program with support services necessitates the

participation of all stakeholders. Thus, the institutional landscape for inter-agency collaboration in the delivery of adequate microcredit and support services via public service delivery system necessitates a working framework for the application of good governance principles in the design and implementation strategies of microcredit programs for poverty alleviation and rural development.

Grameen Replication in the Philippines: Selected Best Practices

Among the four most successful Grameen replicators in the country, the CRBLI figured prominently when it comes to viability because it is the only microcredit program that is financially sufficient and fully profitable. However, using CGAP'S four basic tenets of high-quality microcredit are used as benchmarks, CRBLI, CARD, NWTFI and TSPI pale in comparison with the Grameen Bank, BRAC, ASA and BRI as shown in Table 3.

Table 3. Highlights of Benchmarks for Philippine MFIs

Benchmark	Philippine Microfinance Institution (MFI)			
	CRBLI	*CARD*	*TSPI*	*NWFTF*
Permanence (length of operations as of 2003)	12 years (since 1991)	13 years (since 1990)	21 years (since 1982)	17 years (since 1986)
Scale (number of active borrowers)	1,792	20,617	3,119	9,216
Depth of outreach (type of clients)	Poor/non-poor	all poor	all poor	all poor
Loan Portfolio	$ 1.13 million (as of end-1995)	$ 0.776 million(as of March 1997)	$ 2.20 million (as of end-1995)	$ 0.320 million (as of end-1995)

Cooperative Rural Bank of Laguna, Inc. (CRBLI)

The CRBLI is a Grameen replicator since 1991. As of end-1995, it served 1,792 active borrowers, mostly poor women and managed a PhP28.25 million (equivalent to US$1.13 million) outstanding loan portfolio. It has been singled out for a closer inspection, for two reasons: (1) it is the only institution which is financially self-reliant and viable, serving both poor and non-poor clients, but among them poor women as the large majority; and (2) since 1991, it is a

Grameen Bank replicator, thus combining regular banking and Grameen-type operations (Seibel et. al. 1997:8).

The CRBLI has demonstrated the profitability of microfinance in two respects: both its own original operations with poor and non-poor members and its more recent operations with very poor women under a Grameen-type replication scheme cover their costs and yield a profit (Ibid, p. 18).

Center for Agriculture and Rural Development (CARD)

The CARD, now a rural bank, started its Grameen operations in 1990. As of March 1997, it served 20,617 active borrowers and managed a PhP19.4 million (equivalent to US$776,000.00) outstanding loan portfolio (Hossain and Diaz 1999). It started as an NGO and had 20,880 savings accounts and approximately 26,691 outstanding loans as of December 1998. The bank has ambitious goals: 50,000 active members by 2000 and 150,000 by 2002 (Seibel 1998:16). Despite high rate of interest charged on the loan,

CARD has not yet been able to cover its operating expenses, because of the high cost of operation of this intensively supervised credit program. It takes four to five years for a branch to achieve financial viability and it has so far covered the loss by mobilizing small amount of grants from sympathetic donors and drawing on available low-cost sources of fund (Hossain and Diaz 1999:27).

A good illustration of Grameen replication in the Philippines (see CIRDAP 1999 and FAO 2000) is CARD, with head office in San Pablo City in the province of Laguna. It has modified some of the basic features of Grameen to suit the lifestyle and economic conditions of its poor and landless clientele in the provinces of Laguna, Quezon, Marinduque and Masbate. And CARD is one of the more popular and well-studied Grameen replicator in the Philippines, but it is still struggling to reach desirable levels of outreach and financial viability. Hossain and Diaz (1999:3) identified the Grameen features replicated in CARD microcredit operations, as follows:

1. Targeting women from the low-income households as the clientele;
2. Taking the bank services to the village in place of the normal practice of asking people to come to the bank to avail of the credit facilities;
3. Organizing the prospective borrowers into groups of five like-minded persons with a number of Groups (5 to 8) being federated into a Center;
4. The Center holds a meeting on a fixed day of the week which is attended by the Field Staff of the Bank to conduct the credit business;
5. Group solidarity and peer pressure are used to oversee proper utilization of the credit, which are used as the substitute for the collateral taken in normal credit programs. Group members take responsibility for repaying the loan of a defaulting member. Members are given training to ensure strict credit discipline;
6. Credit is given in small sizes with progressively higher amounts for repeat loans as members gain confidence in utilizing the previous loan. The loan

is repaid within a year, in weekly installments of two percent of the loan amount, so that the repayment would not be a burden to the borrowing household;

7. Developing collective funds with compulsory weekly savings of the members and five percent of the loan amount deducted upfront, for the mutual benefit of the members; and
8. Using credit as an entry point for social development promoted by the institution among members with active involvement of the field staff.

The major differences with the Grameen model are in the selection of the target group, organization of the training program, and in the operation of the collective funds. The CARD provides more intensive training on project management and credit disciplines to the prospective borrowers than the Grameen Bank. In Bangladesh, Grameen Bank uses land ownership (up to 0.2 ha) as main criterion for selecting the target group while CARD identifies its target group on the basis of housing and marketable

assets (up to P25,000) determined on the basis of means tests on prospective members. In Grameen approach, the collective funds is managed by the Group while in CARD approach, it is managed by the Center. A mutual fund is developed to provide insurance against accidents, limited old age pensions and burial expenses (Ibid).

Tulay Sa Pag-Unlad Inc. (TSPI)

The TSPI was established in 1982 targeting the entrepreneurial poor. As of end-1995, it served 3,119 active borrowers who were all poor 64 percent of them women, and 12 institutions. It managed PhP55.9 million (equivalent to US$2.2 million) an outstanding loan portfolio (Seibel, et. al. 1997:8).

It served a total number of 3,024 savers, 64 percent were women. Outstanding total savings as of December 1995 amounted to PhP4.8 million, but only 18.5 percent has been mobilized from women. Of the active loan portfolio of direct lending, 90 percent has been lent to men and only 10 percent to women (Seibel et. al. 1997:8).

Negros Women for Tomorrow Foundation, Inc.-Project Dungganon

The NWFTF was incorporated in 1986. As of end-1995, it served 9,216 poor women-clients and managed a PhP8.0 million (equivalent to US$320,000.00) outstanding loan portfolio (Seibel, et. al. 1997:8). Its *Project Dungganon* (PD) is a Grameen Bank replication program which was started in 1989. As of end-1995 there were 5,866 borrowers with active loan portfolios and 6,952 active savings accounts. Its savings outstanding was PhP3.3 million. However, the major challenge facing the foundation is financial viability given a negative equity and fund balance standing at negative PhP7.2 million.

The study argues that the lackluster performance of Philippine MFIs is largely attributed to poor governance. This is caused by MFIs' inability to create the proper environment that will encourage participation of a larger number of borrowers; lack of monitoring and information about the target clientele; inadequate administrative machinery to enforce contracts and accountability measures;

and lack of support services to facilitate generation of profits from the borrowers' loan-funded projects. The conditions are largely caused by insufficient participatory mechanisms and limited collaboration with government and civil society organizations who are in the best position to provide adequate institutional and technical assistance to microcredit operations.

6

NATIONAL GOVERNMENT'S PERFORMANCE AS A BANKER OF THE POOR

It is argued that the lackluster performance of earlier Grameen replications in the country could be attributed to insufficient attention to good governance processes needed for successful microcredit program operations. Seibel and Torres (1999) report that a study conducted by the Agriculture and Credit Policy Council (ACPC) reveals that Grameen replicating MFIs in the country are donor-driven; their internal resource mobilization is minimal; the interest rates are inadequate; and costs—shared equally between government and replicators—are exorbitant; and the operational self-sufficiency ratio is below average.

Hans Seibel and associates (1997:2-4) conclude that the overall microcredit accomplishment reports and figures from government agencies clearly show that such programs are more symbolic in nature, with only insignificant outreach and impact. Flerida Chan (1989) further delivers a more devastating critique of the microcredit replication in the Philippines. She notes that the Philippine government has performed below par as a banker and its dismal performance in administering credit programs leaves much to be desired.

The existing physical network of financing institutions has not been totally responsive in meeting the credit needs of the marginalized groups in particular. The present credit delivery mechanism has remained inadequate for lending to small farmers. There are two major reasons why this is so: first, the formal financial system is not suitable for rural lending; and second, there is inadequate support for innovative financial intermediation schemes.

Despite the shortcomings of Grameen replication in the country, the Philippine government created PCFC and enabled QUEDANCOR to provide similar microcredit facilities to almost the same type of target clientele. This clearly manifests state commitment towards using microcredit as a strategy against poverty and an integral component of integrated development programs in the countryside.

Despite the issues and controversies in microcredit programs that remain to be resolved, the international donor community and the Philippine government provided

increased foreign and counterpart funds for capital investments in both PCFC and QUEDANCOR (MTPDP 2001-2004). This shows that the administration of President Gloria Macapagal-Arroyo (2001-2004), strongly supports microcredit as an effective tool to enable the poor to free themselves from the trap of poverty and to ultimately enable them to have continued and sustained access to the credit facilities of mainstream commercial banking system.

The increased investments are aimed at increasing the number of partner organizations and beneficiaries, delineating responsibilities and ensuring coordination, ensuring convenient access to information and increasing the profitability microcredit programs and the livelihood activities of beneficiaries. This can be viewed as part of the government's effort to increase self-employment and income of the enterprising poor in the country.

The National Strategy for Microfinance

The Philippine government recognizes the potential role of MFIs in providing microenterprises and small borrowers in general with access to deposit facilities and loans. However, Hans Seibel (1998:2) warns that, any attempt to replicate or expand Grameen replication program should be carried out with great caution.

The National Strategy for Microfinance which was formulated by the National Credit Council (NCC) in 1997 still envisions a significant contribution of microcredit in the overall efforts to reduce poverty incidence in the country. The National Strategy recognized the importance of market-based microfinance and of creating a hospitable policy environment. The strategy called on the government to create an appropriate policy environment that will encourage more participation by rural banks, credit cooperatives and credit-granting NGOs in the delivery of microfinancial services to the basic sectors. The first step adopted by the government has been to work for the dismantling of a

number of subsidized credit programs that compete with private initiative in microfinance (Llanto 2001:3).

Due to the failure of directed credit programs in the past resulting to a huge waste of scarce government resources, Executive Order 138 issued in August 1998 directed government non-financial agencies to stop their involvement in direct lending and to use financial intermediaries instead in providing loans to target sectors. Executive Order 138 also provided a phase-out schedule for subsidized credit programs in the non-agriculture sector. It thus complements the Agriculture and Fisheries Modernization Act (AFMA) of 1997 which has earlier sought the phase-out of all subsidized credit programs in the agriculture sector and the creation of a market-based financing mechanism for the sector (Ibid.).

In its totality, microcredit is more than just credit for the poor; it is a vital component of rural development. Microcredit can play an important role beyond enterprise development in supporting the livelihoods of the poor. The

concept of livelihood is broader than that of enterprise development. It considers a mix of resources, activities, and capabilities that enable individuals and households to pursue their economic goals. In reality, resources within households are fungible, and it is important to recognize that clients will use microfinance services for a variety of purposes. Clients use microcredit not only to invest in enterprises, but also to build household assets, smooth income, and help manage their cash flow. By providing chunks of money when it is needed, microcredit can help clients reduce their vulnerability, expand their options, and graduate from a reactive mode of survival to a proactive climb out of poverty (Sebstad and Cohen 2000:115).

Microfinance Rhetoric in the General Banking Law

The National Strategy for Microfinance was strengthened by the General Banking Law of 2000 by making microfinance a part of mainstream banking in the Philippines. Republic Act 8791 mandates the Monetary

Board to formulate appropriate rules and regulations on microfinance operations. However, the realities appear to be different from the rhetoric of the law. Llanto (2000:3) laments that despite support for microcredit in the General Banking Law of 2000, realities on the ground appears to be biased in favor of the traditional commercial banking practices. Although banking regulations do not prohibit the grant of small clean loans, the Bangko Sentral ng Pilipinas' (BSP) stance on small clean (unsecured) loans supported by informal information is not clear and, worse, vague to banks subject to BSP supervision. In practice, there has been a traditional regulatory bias against microcredit—the grant by banks of loans with insufficient collateral or without any form of security or collateral.

The Key Variables in Microcredit Programs

Making the government-driven microcredit strategies work more effectively for the poor will require good

governance mechanisms to ensure its applicability to the prevailing local conditions and appropriateness to the credit needs and financial capabilities of its intended beneficiaries.

The key factors that could contribute to the success or failure of microcredit programs should likewise be anchored on the peculiar characteristics not only of the livelihood activities and micro-entrepreneurial capabilities of the rural poor and non-bankable groups, but also their household financial conditions, credit needs, experiences, creditors, credit demand as well as their preferred implementation strategies for a microcredit program that involves their communities, formal and informal community leaders, local institutions, and social networks.

Good governance offers new perspectives towards making microcredit as one of the more applicable and appropriate strategies for rural development and for tackling the poverty problem. Good governance aims to attain sustainable human development in accordance with global

efforts to improve the quality of life of the disadvantaged and vulnerable groups.

An enlightened appreciation of local socio-economic and credit infrastructure will enable planners and implementors to capitalize on the principles of good governance for sustainable human development as the primary mechanisms that will lead to the application of appropriate strategies and effective government-driven anti-poverty and other development interventions for the disadvantaged and vulnerable sectors in the rural areas. Hence, in order to formulate appropriate implementation strategies for microcredit programs and other microfinancial services as part of a comprehensive anti-poverty intervention for the marginalized minorities, good governance is necessary.

It is argued that the financial conditions of rural poor households are the primary determinants of their mechanisms for survival (Warner 1997; Otero 2001). In the absence of other options, local credit services become one

of their means to satisfy the family's basic needs. Hence, the poor households' credit experiences are conditioned by their need for credit and availability of creditors in their neighborhood and in the immediate community. On the other hand, the borrowers' capability to pay largely determines the size of credit they need. For example, Philippine MFIs generally provide small loans to the enterprising poor ranging from PhP1,000.00 to a maximum of PhP25,000 per individual end-borrower. Since the poor are generally classified as non-bankable, small loans are deemed appropriate for their repayment capabilities.

Any government-sponsored microcredit programs will become appropriate if targeted at microcredit preferences and demand of target beneficiaries. Thus, the integration of good governance in the design and implementation strategies of microcredit programs provides a working framework necessary for the reduction of poverty incidence within a particular geographic pocket of interest. This framework is anchored on local contexts and realities at the community, household and individual levels. Hence, the

factors and conditions that this study will investigate include household financial conditions, credit experiences, microcredit preferences and demand as well as the implementation strategies based on the principles of good governance.

Household Financial Conditions

Household financial conditions as defined by sources of income, amount of income and expenditures as well as net cash savings/deficits largely determine how microcredit program should be designed and implemented. These indicate how the poor households manage risks that affect the family, money management strategies and their mechanisms of coping with daily household expenditure requirements and unanticipated events such as accidents, illness or death. Since the poor do not separate business from household transactions, credit becomes an integral component of the poor's struggle to manage their economic activities and vulnerabilities, to satisfy the family's needs for survival and to continuously improve quality of life.

Household financial conditions can be determined using three criteria: (1) main source of income; (2) estimated net cash flow; and (3) type of dwelling unit. The main source of income reveals the main economic activities used to support the needs of all household members such as direct income from economic activities and income transfers from affluent relatives or family members. The estimated net cash flow determines the actual amount of cash left after all household expenses have been deducted from the total household cash revenues. The type of dwelling unit and its ownership readily show the poor's accumulated wealth. House and landholdings can also be used as collateral for commercial bank loans depending on its quality and market value.

Understanding household cash flow (total income minus total expenses) and how people repay or save is the key to explaining the role played by financial services in the lives of poor households (Llanto 2001:1, Satyamurti and Haokip 2002:2). In the cash flow analysis, all the sources of income, both from farm and non-farm activities, as well as

the overall expenditures of the farm household are considered. As the net cash flow depends on all sources of income, farm households with diversified revenues have more possibility to obtain larger loans. These farmers can also repay their loans in more frequent installments and thus, reduce the risk of loan default for the lender. The cash flow analysis assists the lender in designing a manageable loan repayment strategy (Klein, et. al. 1999:50).

Because income does not arrive in exact rhythm with outflow of expenditure, microcredit facility is needed. The poor need it no less than other groups of people. Indeed, *they may need it more*. This is not just because their incomes are uncertain and irregular (which is often true), but because the absolute amounts of cash they deal with are very small. As a result, anything more than the tiniest expenditures will require sums of money greater than what they have with them at the time—in their pocket, purse or home. Expenditure of almost any kind can require them to look for a way of financing the expenditure, or part of it, out of yesterday's or tomorrow's income. For example, basic

needs in life cycle events, such as birth, schooling, marriage, home-making, retirement and death, emergencies including personal ones like illnesses and accidents and impersonal ones like cyclones, fires, floods and droughts, all require the expenditure of sums bigger than those available on an everyday basis. Besides needs, there are opportunities–opportunities to invest in land, business, buildings and comforts like fans and TVs. These too, involve spending sums that force the poor to look for ways of using past and future, as well as presently available incomes (Rutherford 2000).

The minimum basic needs approach to human well-being is a function of household financial conditions and sources of income. Central to poverty alleviation initiatives and governance for sustainable human development is the enhancement of the capability of the household members to generate resources to satisfy the families' survival needs and to ultimately attain better quality of life. It is also a primary input for determining extent of poverty, credit needs and financial capabilities of intended microcredit

beneficiaries. Hence, household financial condition is a crucial factor in making the good governance mechanisms in microcredit programs applicable and appropriate to the community and target beneficiaries, respectively.

Credit Needs of the Poor

The poor need credit for two main reasons. The first lies on how the family copes with daily needs for survival, and the second lies in generating enough financial resource base for their livelihood and microentrepreneurial activities. Since credit can be used either for survival or for income augmentation, microcredit programs can become applicable and appropriate if they adequately respond to the microcredit and human development needs of target beneficiaries.

Program credit has a significant effect on the well-being of poor households and this effect is greater when women are the program participants (Pitt and Khandker 1996:vi). Lack of access to credit is the biggest constraint on the poor. They need no other outside inputs to increase

their incomes and are themselves the best judges of how to use the credit extended to them. Not only would credit help the poor women acquire self-esteem, but their extra income would bring about better living conditions for other family members, especially children (Khandker, Khalily and Khan 1995:xi-xii). But the loan must be backed up by a viable project and the entrepreneurship and managerial capacity of the borrower to run the project (Tolentino 1987:5). Another important consideration is not to overlook the distinct culture and way of life of the poor, small, rural farmer-borrowers in general (Chan 1989:3).

Understanding client behavior goes beyond simply looking at how borrowers use and repay loans. It requires an awareness of (1) the economic goals of poor households, (2) how people manage resources and activities in the context of their household economic portfolios, and (3) how they deal with risk in their day-to-day lives. With this starting point, it is possible to see how financial services fit into the process. These factors all affect clients' capacity to assume debt, bear risk, and effectively use financial resources to

generate a stable income flow and build assets. Ensuring that the terms, conditions, and delivery of financial products and services correspond to the financial cycles of clients can reduce risks for both clients' and lenders' portfolios. Products and services that respond to clients' needs provide the basis for programs to expand and deepen their outreach and achieve the dual goals of impact and sustainability (Sebstad and Cohen 2000:114).

Worldwide experience shows that microcredit responds to both the survival and other well-being needs of the impoverished clientele. However, the delivery and recovery of appropriate amounts of small credit largely depends on the credit needs and entrepreneurial as well as financial capabilities of the borrower based on the financial viability of their microentrepreneurial and livelihood activities. All these are supportive of their struggle to move out of the poverty trap and to attain better quality of life for the family.

Credit Experience

The type of credit availed of forms part of the poor's life cycle and their day-to-day struggle for survival and better quality of life. The bankable groups are able to benefit from commercial credit facilities. The less bankable and less poor are able to access credit facilities of semi-formal creditors such as cooperatives and NGOs. The poorest and most vulnerable usually depend on informal credit from relatives, friends and other local moneylenders.

Both microcredit programs and good governance are cognizant of the importance of credit in the human well-being of the poor. However, credit assistance for the heavily indebted poor may push them further into indebtedness, and may result in the enforcement of accountability measures that may destroy their main source of livelihood. Hence, examining the intended beneficiaries' credit experiences will help determine how microcredit can make significant and timely contribution in mitigating poverty conditions and in

putting the beneficiaries in the appropriate microcredit stream.

Microcredit may not be exclusively used for livelihood and microentrepreneurial activities. It is important in coping with economic shocks brought about by adverse weather or social conditions such as natural calamities, illnesses, death, religious obligations and family responsibilities. Hence, it is vital to scrutinize how credit affects the household's socio-economic conditions in order to determine how microcredit strategies can assist the poor in meeting their needs as conditioned by the manner in which they have used credit in the past.

Development practitioners, policy makers, international development agencies, and other governance partners have to recognize that providing efficient microfinance services for the poorer segments of the population is important for a variety of reasons. Improved access and the efficient provision of savings, credit and insurance facilities in particular can enable the poor to

smoothen consumption, manage risks better, build assets gradually, develop microenterprises, enhance income earning capacity, and enjoy improved quality of life. Microfinance services can also contribute to improvement of resource allocation, promotion of markets, and adoption of better technology, thus, microfinance helps to promote economic growth and development. Hence, to increase the overall impact of microfinance on poverty reduction, it is essential to extend a wide range of services on a continuing basis to the poor who are still excluded from the benefits of microfinance (ADB 2000).

At the field level, the target clientele should have strong institutional base for which intensive training and motivation programs should be implemented. The MFIs and SHGs should formulate and implement appropriate credit delivery and collection procedures to make their lending programs viable. Aside from developing institutional capability, there is also a need for developing their technical skills in production and marketing. Credit programs should be specifically designed considering the characteristics of

the targeted group of beneficiaries and the environment in which they operate. This suggests that in designing a credit program among others, the borrowing capacity of the clientele and the distinctive climatological and geographical attributes of their location should be noted (CIRDAP 1999:49-50). These attributes are crucial determinants in the assessment of the rural poor's access to microfinancial services, loan utilization and repayment.

Access to Loans

Lack of access to credit has plagued poor farmers and rural dwellers for many years. Rural people need credit to allow investment in their farms and small businesses, to smoothen consumption, and to reduce their vulnerability to weather and economic shocks. Because they have little access to formal financing institutions, poor rural people follow suboptimal risk management and consumption strategies and rely on costly informal credit sources. Recognizing this, governments and international agencies created banks and lending programs targeted at rural

farmers. The track record of these programs is mixed, especially with regard to reaching the poor. Reforms and innovations have emerged in recent years to improve credit market opportunities for the rural poor and increase the efficacy of rural finance (FAO 2000).

Maintaining access to MFI program credit, in itself, is a protectional risk management strategy for many clients. They go to great lengths to ensure repayment, particularly when confronted with a crisis or shock, often by mobilizing informal sources of finance to ensure repayment. Repayment means access to a new loan to start back on the road to recovery, to restock a microenterprise, to rebuild a house, to pay school fees (CGAP 2000). Access to loans also may decrease the level of other assets held for precautionary savings. This form of 'insurance' may increase investments in and allocation of human and physical capital to current and future income generation. Finally, easy access to loans may decrease emergency sales of productive assets at low prices (Diagne in Sebstad and Cohen 2000:84).

Access to credit by the poor is a critical element in enhancing productivity and income. The strategies for poverty reduction and rural development highlight the crucial role of credit along with financial sector reforms and have opened up new possibilities for increasing the share of the rural poor in institutional credit (CIRDAP 1999:iii).

Loan Utilization

Different studies proved that the poor clients are prone to using credit beyond what the loan is originally intended for. Littlefield and associates (2003:1-2) conclude that microcredit, and the impact it produces, go beyond just business loans. The poor use financial services not only for business investment in their microenterprises but also to invest in health and education, to manage household emergencies, and to meet the wide variety of other cash needs that they encounter.

Both lenders and borrowers acknowledge that loan funds are fungible. Fungibility refers to the interchangeability

in the way by which money is being used. For example, loan funds may be used to defray other expenses not related to the purpose of the loan. While in the past fungibility has been seen as a problem within the context of credit for the poor. This belief is less prevalent today. The industry increasingly recognizes that flexibility in the use of loan funds enables borrowers to allocate the funds to their best advantage at a given point in time. Because of its dynamic nature, flexibility in loan use is the key in the comprehensive efforts to reduce vulnerability.

The nagging concern that, without supervision, borrowers from poor households will ‘consume’ rather than ‘invest’ their loans and therefore have no way to repay them has been proven to be unfounded. The bulk of loan funds are used for a wide range of investments. Another concern—that clients will waste resources by investing loan funds in something they would have invested in anyway (substitution)—reflects a narrow and linear view of household money management strategies. Such use may free up funds that households can use in other ways and

provide a chunk of money when it is needed. Fungibility—the interchangeable nature of resources—is not a problem for microentrepreneurs; it is a solution (Sebstad and Cohen 2000:76).

Loan Repayment

All loans require regular repayments. If the returns on investment on the loan are negative, or if the individual or household has experienced another kind of shock that has affected its income flow, it may be necessary to deplete assets or reduce consumption to make those loan repayments. If a client defaults on a loan, he or she may risk falling out of the financial market altogether and may lose access to this mechanism that may allow him or her to cope with other types of risks. Moreover, clients may deplete social capital by asking friends and relatives for money to repay loans. Being unable to repay on time or at all may strain or break relationships with other members of the credit group, may erode social standing, and may destroy good will. Defaulting on a loan also may cause loss of face, self-

confidence, and self-esteem, all of which are important human assets. The negative consequences of loan default are well recognized. As the field studies have shown, maintaining access to a source of credit is an important coping mechanism and a key factor that drives clients to repay their loans (Sebstad and Cohen 2000:42).

Microcredit grew out of two new ways to judge the repayment risk of the self-employed poor: joint-liability groups and loan officers who make detailed personal and financial evaluations of individual borrowers and their homes, businesses, and collateral. The challenge of microcredit is to judge the risk of whether the self-employed poor will repay their debts as promised (Schreiner 2003:1-2). Generalizations about the length of the *repayment period* are somewhat tenuous. Loans from merchants, landlords, and traders are often linked to a relevant production cycle. On the other hand, the terms and conditions of the loan from the formal sector will include a specified repayment period and, where the size of the debt is large, that repayment period may extend over a fairly long period of time (Dunn 1996:10).

Credit experience is generally confined to the cycle of borrowing, using borrowed funds and repayment. The cycle repeats after repayment and so on. As the cycle of credit experience increases, mutual trust and confidence for both the creditor and the borrower develops over extended periods of creditor-debtor relationships. The nature of this relationship can also be viewed from the perspective of agency-client relationships which will eventually strengthen social capital and productive economic interdependence. The governance perspective in microcredit management involves debtor-creditor relationship that develops in the participation of both parties in the debtor-creditors' economic and financial interchange and thus employs mechanisms of awareness of debtor activities and motives. Despite fungibility of loan funds and dynamic motives, if the debtor still honors credit obligations and financial accountabilities, he/she enjoys continued access to loan funds as long as it is needed.

Credit Providers for the Poor

Institutional providers of microcredit services use alternative mechanisms to ensure that microcredit programs reach the intended beneficiaries. Microcredit relies on peer group schemes that do not arouse the interest of the non-poor. Such schemes further make the presence of rural elite intimidating to the poor. The governance perspective could help ensure that the intended beneficiaries participate in microcredit programs through homogeneous self-help groupings; become fully aware of the processes, decisions, actions and motives of each other; implement credit discipline; and enforce and honor accountability measures towards each other and to the creditor. The ultimate goal of this effort is to ensure that long-term benefits of microcredit accrue to individual group members consistently and continuously.

In general, the reasons for borrowing can be classified into two broad categories. Borrowing for consumption purposes is intended to meet the daily or

seasonal needs of the household or to finance contingencies. The second category includes borrowing intended for production and investment purposes. Due to the fungibility of credit, these discrete categories may not be very useful in practice. Debt can be incurred from a number of sources, both formal and informal. The contrasts between the formal and informal sources can be at least partially understood by examining differences in the terms of debt. Formal sources of debt are characterized as being primarily for production purposes, secured by collateral, having high transaction costs, and with interest rates that are lower than many informal sources. Borrowing from the formal sector often involves larger loan sizes and longer repayment periods. Because of these characteristics, formal sources tend to be inaccessible to microentrepreneurs and low-income households (Dunn 1996:vii).

Although some have identified an inadequate credit supply as a constraint on production, and hence channeling credit to the rural poor for productive purposes has been emphasized in many developing countries, formal financial

institutions have hardly succeeded in reaching the poor. Several types of credit institutions (commercial banks, specialized agricultural credit agencies, rural banks, cooperatives and government-supported projects) have been widely used to deliver rural credit. Because of deliberate policy and for other reasons the interest rates were held below the market-clearing rates and credit was thus rationed. Evaluations have found that the rich rural elite have been the principal beneficiaries of these credit programs and, thus, the major portion of the credit did not reach the intended beneficiaries—the poorest rural households (World Bank 1975 in Pitt and Khandker 1996:v).

An Asian Development Bank (2000) study concludes that most formal financial institutions do not serve the poor because of perceived high risks, high costs involved in small transactions, perceived low relative profitability, and inability of the poor to provide physical collateral usually required by such institutions. The business culture of these institutions is also not geared to serve the poor and low-income households. Lacking access to institutional sources of

finance, most poor and low-income households continue to rely on meager self-finance or informal sources of microfinance. However, these sources limit their ability to actively participate in and benefit from the development process.

Microcredit Preferences and Demand

One of the challenges for MFIs is the extent to which microfinance programs can respond to the demand for individual loans rather than group loans among some borrowers. Some borrowers, especially those from better-off households, are not able or willing to bear the high borrower transaction costs associated with group lending systems. In some cases, high borrower transaction costs are related to weak group dynamics, cumbersome group size or processes, or the process of ‘weeding out’ the less credit-worthy group members that often goes on during the formation phase. In other cases, it relates to variations in the credit-worthiness of group members or loan terms and conditions that are too rigid. Nevertheless, many women

highly value the opportunity to participate in credit groups. While the opportunity cost of their time is high, that cost is outweighed by the benefits of building social assets, developing new skills, and gaining other benefits through participation in credit groups (Sebstad and Cohen 2000:112).

One of the main issues in microcredit is *loan size*. Small loans, it is said, are simply too costly to administer, and the profits from such lending are too meager to permit profitability. However, a study examining some of the best MFIs concludes that this conventional wisdom is quite wrong. The MFIs can and indeed need to be self-sustaining if they are to achieve their outreach potential providing rapid growth in access to financial services by poor people (Malhotra 1995). Hence, financial viability objectives could be attained through economies of scale—by serving a large number of borrowers with good repayment record.

The most obvious cost associated with a loan is the amount of the *interest payment*. There can be a wide variation in interest rates among the different sources of

debt. In general, there will be a narrower range in the interest rates charged by different lenders in a given country's formal sector, due in part to regulation. The interest rates charged by the formal sector will tend to be greater than the nominal interest rates charged by relatives and neighbors but less than the interest rates charged by other lenders in the informal sector (Dunn 1996). That is, profitable interest rate is attainable through economies of scale by providing credit facilities to a large number of credit-worthy and good paying borrowers from the poor and disadvantaged sectors especially in the rural areas.

Transaction costs represent another potentially significant cost of debt. Transaction costs are the costs associated with gathering information about a loan, applying for or requesting a loan, negotiating the terms of the loan, and carrying out the terms and conditions of the loan agreement. These costs may be in the form of direct cash outlays, such as for transportation or application fees. Often, the most significant transaction costs occur in the form of the value of time spent. The borrower's transaction costs are

generally believed to be highest when borrowing from the formal sector, due to the amount of time expended in traveling to the location of the lender and in completing the loan application process (Ibid).

Also important among the terms of debt are the nature of the assurances that the borrower will repay the lender and the sanctions that can be imposed in the event of default. The main feature of credit from the formal sector is its requirement that the borrower should offer restricted types of *collateral* (i.e. land and immovable assets) in order to receive a loan. In the informal sector, a collateral may sometimes be required, but there is a wider range in the types of pledges that will be accepted, including moveable assets, household items, and promissory notes. Many loans in the informal sector are extended without any type of collateral or pledge. However, the borrower of an unsecured loan may experience an equally strong (or stronger) incentive to repay the debt, due to the types of social pressures and *social sanctions* that can accompany default. Higher repayment rates in the informal sector are often

attributed to the strength of social sanctions as well as to the higher quality of the information that informal lenders have regarding the credit-worthiness of potential borrowers. Default in either the formal or informal sectors can also be discouraged if it is associated with loss of access to future borrowing (Ibid).

In microcredit programs, the healthy balance between pro-poor social equity value premise of New Public Administration (Frederickson 1971) and pro-capitalist financial viability objectives of the Entrepreneurial Government (Osborne and Gaebler 1992) is attainable through economies of scale. This means that the profitability of the livelihood activities of a large number of borrowers from the poor and disadvantaged sectors results to proven track record in full loan repayment. The final consequence of 100 percent repayment rate for microcredit programs is financial viability—the full recovery of the cost of microcredit operations plus positive profit and acceptable rate of return on investment.

The role of public administration and good governance in microcredit for poverty reduction is for the government to create an environment that will catalyze interactive economic engagements among all governance actors, partner institutions and other stakeholders. The viable economic interactions would further ensure the government-driven microcredit programs' positive and sustainable impact to local socio-economic conditions, especially on the overall quality of life of the poor and the vulnerable families in impoverished communities.

Need for Support Services. Unfortunately many schemes do not have the resources or the staff to provide more than the credit component. Many of the people working on microcredit schemes do not have the experience to properly advise the borrowers on the technical and business aspects of their intended activities. Hence, schemes with wider social and economic empowerment objectives for the participants have generally performed better. Particularly important are business development and business skills trainings in helping the borrower to identify a viable income-

generating activity and how to run the activity properly (Liew 1997).

The minimalist approach (just focusing on the provision of credit), while it has worked elsewhere, has not proven to be successful in the Pacific. A large number of schemes do not come with a comprehensive package of services and are just concerned with the disbursement and collection of money. Experience in the Pacific has shown that credit alone is not sufficient to ensure that borrowers succeed in their income generation projects. They require business skills training and on-demand technical and marketing advisory services to help them deal with unexpected problems. For schemes targeting women and the poor, many of whom come from non-business background and culture and generally lacking self-esteem and confidence, it is even more important that skills and capacity-building support are available (Ibid).

The delivery of a comprehensive package of credit and support services could not be accomplished by the

public service delivery system alone. Although microcredit is normally delivered by non-government entities, they don’t have the institutional capacity to provide support services such as trainings, technical and marketing assistance to their clientele. Hence, it is vital that microcredit is embedded in a much larger integrated area development program for poverty reduction. Appropriate government response to the heterogeneous poverty conditions, credit needs, capabilities, preferences and demand of targeted beneficiaries will require institutional arrangements that will directly affect technical, entrepreneurial, marketing and local economic capacity. Strengthening institutional capacities for collaborative engagements will help the government catalyze, promote and coordinate public services to ensure positive economic impact and outreach to impoverished target beneficiaries.

The good governance perspective emphasizes effective and consistent implementation of microcredit programs. It focuses on the state’s functions in steering institutional triad of collaborative engagements among

governance partners from the business sector and civil society. This aims for the creation of an environment where microcredit can make a difference in the lives of the poor. It also emphasizes the role of the state in providing incentives for participation in microcredit programs and in ensuring that the long-term benefits of microcredit accrue to the socio-economic or human development of intended beneficiaries.

7

MICROCREDIT STRATEGIES

The emphasis on good governance is not that it is an end in itself. Rather it is a means towards a certain end; the attainment of the ultimate goals of society—human well-being. As a development intervention, microcredit strategies therefore, need to be firmly anchored on the principles of good governance for sustainable human development. According to Chalker (cited in Leftwich 1993:605), at the core of contemporary development ideals is the confident assertion that ‘good governance’ is not simply desirable but an essential condition for development in all societies. Hence, the operationalization of good governance principles in the development of microcredit strategies is essential in order to make microcredit as a potent weapon against poverty and an effective tool for rural development.

Microcredit has been recognized as an effective tool and viable program for poverty alleviation (Satyamurti and Haokip 2002:8). However, many microcredit schemes do not carry out a realistic assessment of the income generation potential in a particular locality before implementation. It is often assumed that there are limitless potential and that the

availability of credit will unleash latent entrepreneurial potential. This assumption resulted to the failure of many outer island and rural village microcredit schemes (Liew 1997).

To design successful products, the first step entails understanding the financial needs of clients (and potential clients) and how financial services fit into their money management strategies. Understanding clients requires an awareness of the economic goals of poor households, how people manage resources and activities, and how they deal with risk in their day-to-day lives. Such a framework can be a useful starting point to better understand financial service preferences of poor households (CGAP 2000:1). Designing new delivery systems that can efficiently reach the poorest segments of society, therefore, makes up the biggest challenge of our governments in the coming years (Shams 1995:304).

On the other hand, the replicability of Grameen's credit delivery system rests on the following:

1. The exclusive targeting of the bottom poor, based on clear-cut eligibility criteria for selection of clientele;
2. The organization of borrowers into homogeneous groups and the building of group solidarity through a participatory organization development process;
3. The close rapport between the bank staff and the clientele groups. All bank transactions are transparent and close to the customers. With Grameen, ‘the poor do not come to the bank, instead the bank goes to the poor’;
4. A professionally trained and motivated staff capable of establishing rapport and interacting with its clientele; special loan conditionalities, which are particularly suitable for the poor;
5. A simultaneous social development agenda that can address the basic needs of the clientele; and
6. The promotion of a problem-solving culture within the organization based on continuous experimentation and social learning (Ibid, p. 306-307).

The application and appropriateness of good governance principles in replicating microcredit programs have to fully take into account the desired end result—which is sustainable human development—and the contexts that shape its attainment. In this view, any solution to the problems of rural people does not lie in uniform solutions which are decided at the top. Rather, they must be found within the social capabilities of individual villagers who have intimate knowledge of their needs and problems, their resources, and their capabilities. The adoption of a structure that is producer-oriented and a program suited to the needs and capabilities of the rural people ensures not only participation, but also two-way interaction between producers and the professionals who are responsible for implementing programs (Mascarenhas 1993:486).

Hilton Root (1996:146) argues that development cannot exist without good governance. Thus, microcredit as a strategy for poverty reduction and rural development requires the application and utilization of appropriate good governance mechanisms in microcredit programs. The

United Nations Development Program (1997:19) characterizes good governance as sustainable, participatory, accountable, legitimate and acceptable to the people, transparent, promotes equity and equality, able to mobilize resources for social purposes, strengthens indigenous mechanisms, efficient and effective in the use of resources and service-oriented, among others.

The replicability of Grameen-type microcredit delivery mechanisms and implementation strategies for the rural poor in Western Mindanao necessitate the identification of strategies based on client's needs, perspectives, preferences and capabilities. These, however, need to operate within the framework of governance for sustainable human development (UNDP 1997) focusing on the principles of participation, transparency, accountability and sustainability.

Participation

Participation lies at the heart of good governance (UNDP 1997). The principle of participation derives from an acceptance that people are also at the heart of development. They are not only the ultimate beneficiaries of development, but are also the agents of development. In the latter capacity, they act through groups or associations and as individuals. For all economies, though, the benefits of participatory approaches can be considerable. These include improved performance and sustainability of policies, programs, and projects, as well as enhanced capacity and skills of stakeholders. At the grassroots level, participation implies that government structures are flexible enough to offer beneficiaries, and others affected, the opportunity to improve the design and implementation of public programs and projects. This increases “ownership” and enhances results (The World Bank 2001).

Good governance encourages actors to participate and take their demands to additional areas of concern. It

can target a variety of levels, from policy reform, to program and project delivery, at the central or local levels (Coston 1998:491). The emerging participatory 'paradigm' in microcredit suggests two perspectives advanced by Britha Mikkelsen (1995). The first of these consists of substantively involving local people in the selection, design, planning and implementation of programs and projects that will affect them, thus ensuring that local perceptions, attitudes, values and knowledge are taken into account as fully and as soon as possible. The second is to make more continuous and comprehensive feedback an integral part of all development activities.

Popular participation is operationalized through a wide range of community-based participatory planning methodologies. As with the crystallization of all good ideas, 'popular' participation has turned from initial euphoria to reflection and innovation. It is a basic principle of community participatory methods that the starting point for empowerment should be the internal knowledge, priorities and perceptions of local people. The problem is that,

ignoring the external economic organizational and political context of community participation can undermine key components of local sustainability: livelihood security, social cohesion and environmental stability. Hence, a more inclusive model of local participation is one that brings about local economic, social and environmental sustainability by drawing into the 'popular' participation process those stakeholders with institutional and political influence (Warner 1997:415-417).

In the realm of good governance perspectives for microcredit programs, people's ability to draw on relationships with other people on the basis of trust and reciprocity is a social capital and an asset. Social capital is central to peer-group lending inherent in microcredit programs. Such reciprocal relationships are the essence of community organizations, which collectively work for the betterment of their community through collective action. In providing an enabling environment for the poor to fight against poverty, these social assets have to be encouraged and groomed (UNDP in Satyamurti and Haokip 2002:6).

Social capital in this context may include the reciprocal understanding of each other's self-employment experience, the mutual support in words and actions, or even trust. Without a minimum degree of social capital among members in the same group, they would not agree to stay together or even to form a group in the first place (Hung 1999:5). Thus, without social capital—being a building block of participatory schemes in good governance and microcredit strategies—peer group will break apart and group-based microcredit programs may fail. In this view, a more participatory approach to needs assessment and determination of "the way life is" in similarly situated communities will provide vital inputs for needs-based and client-oriented program design and locally acceptable implementation strategies.

Transparency

Transparency is one of the core pillars of good governance (UNDP 1997, World Bank 2002, ADB 2003). Transparency means that decisions taken and their

enforcement are done in a manner that follows rules and regulations. It also means that information is freely available and directly accessible to those who will be affected by such decisions and their enforcement. It also means that enough information is provided and that it is provided in easily understandable forms and media (UN-ESCAP 2002). Transparency in microcredit programs means that information on the credit-worthiness of prospective borrowers takes a central place in loan appraisal. Transparency in client affairs and the ability of the prospective borrower to present a realistic investment plan and loan application are crucial elements for the lender (Klein, et. al. 1999:50-51).

The benefits of transparency include: (1) *improved performance*—the right information helps MFI managers to identify areas for improvement and make better decisions. Available information also allows managers to compare themselves to industry benchmarks and peers, thereby giving strong incentives to boost performance; (2) *transparency attracts funders*—accurate, standardized

information lets donors and other investors understand the performance of an MFI and make informed funding decisions. They can then track financial and social indicators to determine whether expected results are forthcoming; and (3) *client protection*—MFI clients deserve clear, straightforward disclosure of product terms, especially interest rates. In client-owned cooperatives and other deposit-taking institutions, published performance information tells clients about the quality of management and the safety of their deposits (CGAP 2002).

Peer group lending has gained worldwide recognition as a microlending technology. It has been argued that one of the main factors for its success is weekly meetings which are far more important than the groups themselves; as they play a key role in increasing discipline, ensuring regular payments, and promoting the transparency of financial transactions with bank staff (Jain in Maclsaac 1997). As one of the core principles of good and effective governance, the World Bank (2002:43) concludes that it is imperative to promote efforts to increase transparency and feedback

among beneficiaries of government services. This further includes the involvement of civil society organizations in the design, delivery, and monitoring of development projects and other activities.

Accountability

Accountability is also central to good governance (Sisk 2001:172). An organization is accountable to those who will be affected by its actions. Who is accountable to whom varies depending on whether the actions taken are internal or external to the organization. Not only governmental institutions but also the private sector and civil society organizations must be accountable to the public and to their institutional stakeholders. Accountability cannot be enforced without transparency and the rule of law (UN-ESCAP 2002).

Accountability can be strengthened by promoting community participation in identifying priorities for social programs and in implementing them (The World Bank

2002:40). Accountability of program implementors and borrowers therefore, is a key requirement of microcredit programs.

Accountability measures in group lending rely on peer pressure to monitor and enforce contracts, provide an incentive for borrowers to repay, and help screen good borrowers from bad borrowers. In the Grameen Bank approach, while activities both at the borrower and bank levels are closely monitored, a certain degree of decentralization in operations is carried out which gives branches an opportunity to decide independently on matters that concern their area of operations. Moreover, the scheme has adopted a system of record-keeping which appropriately suits their clientele. Since most of the loanees are illiterate, paper requirements and loan procedures are kept to a minimum and are simply designed with built-in control mechanisms (Chan 1989:3-4).

In this view, successful microcredit operations rest on two basic accountability parameters: client discipline and

institutional discipline. Client discipline refers to the accountability of borrowers to each other and to the creditor. This means that the poor people take responsibility for their decisions, agreeing to and making timely payments of the principal and an amount of interest that will cover the full cost of the service. By living up to their contract, poor people discover their own capacity to direct their future. As Grameen Bank founder Mohammad Yunus said in 1998; "*Credit without discipline is nothing but charity. Charity does not overcome poverty."* Client discipline serves not only the individual client, but also other clients, future clients and microcredit institutions (CGAP 2002).

Co-signing of loan contracts and moral persuasion are effective means to enhance good client discipline. Two types of guarantors can be used. The "moral guarantors" who have a close relationship with the borrower household used mainly as a prevention against moral hazards and "personal guarantors" who are appraised in the same way as the borrower and, in case of loan default, they are

responsible to meet all the loan obligations (Klein, et. al. 1999:57, 61).

Institutional discipline, on the other hand, refers to the accountability of program implementors and partner organizations to each other, to the clients, to the government and to the donor. In this context, institutional accountability refers to the set of principles that lead to sustainability of the program, quality of service, and efficiency of operations, including:

1.) charging of interest rates that cover all costs, even when adjustments are made for donations and subsidies to reflect market rate cost of funds;
2.) requiring full, on-time repayment from clients, and tracking repayments in regular and frequent manner;
3.) creating products and delivery techniques that are appropriate for clients;

4.) investing in management information systems that provide timely and appropriate guidance to staff and management;

5.) providing field staff with performance incentives;

6.) introducing sufficient decentralization to permit agility and eventual scale-up; and

7.) planning from the start for capacity, growth and sustainability (CGAP 2002).

The microcredit approach of Grameen Bank, for example, promotes social development by making the poor individually and socially accountable. Such intermediation improved the productivity and income of the poor (Khandker, Khalily and Khan 1995:ix). Although credit is given to an individual member, the group is ultimately responsible for repaying loans, as well as for maintaining financial and social discipline (Ibid, p. 10). The processes in mutual guarantee and enforcement of co-signing agreements are necessary to enforce accountability measures in a credit system with no collateral (Figura 2002:177).

According to Pitt and Khandker (1996:12), group-based credit is packaged with both responsibilities (meeting attendance, forced saving, shared default risk) and benefits (training, insurance, consciousness-raising). The cost of credit includes not only the interest rate, but also the timing of repayment and the penalties associated with default. In some sense, the monitoring of credit use makes all program participants "credit constrained." Moreover, if there is no monitoring of the use of borrowed funds and no group responsibility and decision-making in the lending program, individuals would likely want to borrow much more than they actually need in order to capture the premium associated with the soft terms of the loan. Hence, accountability—in the form of institutional and client discipline and enforcement of legal measures—is a key determinant of good governance and a crucial performance indicator of microcredit programs.

Sustainability

Theories of development stressing strong local institutional capacity predict a strong correlation with

sustainability (Snow 1999:66). However, development programs are not sustainable if their costs cannot be met over a long period of time. Sustainability is not achieved if programs do not meet the needs of the people they are designed to help. In this context, microcredit programs can only evolve into sustainable institutions if they are linked or partnered with local institutions: churches, post-secondary schools, local governments, credit unions, banks, established non-profit NGOs, service organizations, and job training programs. Ultimately, microcredit programs become sustainable institutions only when net benefits to the community exceed total costs.

The sustainability of the credit institution, therefore, depends on recovering the cost of administration and services from the borrowers (Hossain and Diaz 1999:21). The term program sustainability means the ability of a program to continuously carry out the activities and services in pursuit of its objectives or the ability to continue operating as a development financial institution for the rural poor (Satyamurti and Haokip 2002:36). Financial sustainability

embodies the institutional capacity to become independent of donor or government subsidies (Malhotra 1995). Hence, without a commitment to maintaining, evaluating, and improving programs, sustainability cannot be achieved (Snow 1999:66).

Microcredit fills a niche that banks do not always fill. Grassroots entities providing financial services at the farm level in the form of savings and loan facilities is one of the more promising approaches for building a viable and sustainable financial system for small farmers (FAO 1998). Thus, Satyamurti and Haokip (2002:75) conclude that sustainability is about creating institutions that can provide positive flow of benefits for as long as they are needed. If the people are using the program and graduating to commercial sources of credit, the program is successful and sustainable.

Sustainable human development is the ultimate goal of good governance. Without good governance, development programs become devoid of substance and

meaning. In view thereof, microcredit as an instrument of good governance provides long-term socio-economic benefits for the sustainable human development of intended beneficiaries as long as they are needed; effectively and consistently. Thus, sustainable microcredit programs require good social intermediation and prudent financial intermediation. These are intended to ensure that poverty incidence is reduced effectively and the flow of positive social and economic benefits are received and enjoyed by the beneficiaries continuously and consistently.

8

TOWARDS A THEORY

Theoretically, strong microcredit programs are financially viable while providing long-term benefits to its clientele as long as they are needed. It is argued that the principles of governance—participation, transparency, accountability and sustainability—will improve and strengthen program design and implementation strategies.

The conceptual framework begins with the assertion of FAO (2000) that poverty is both a lifestyle and a trap. It is hard to escape from it. It becomes a vicious cycle wherein the poor not only lack the means to rise above it—trapped in the struggle for day-to-day existence—but also lack the skills and confidence to succeed. Then this study proceeds alongside UNDP's (1997) confident assertion that, since the ultimate goal of microcredit is to free the poor from the poverty trap, it is imperative that appropriate strategies are implemented within the framework of good governance for sustainable human development.

Microcredit program design and strategies should also take into account the factors that enable or limit

successful implementation. Program implementors should likewise be cognizant of the enabling and limiting factors which could help define the terms and conditions of the loan and the target beneficiaries' credit needs as well as their financial capabilities.

Furthermore, it is necessary that microcredit program design, implementation strategies and public support services are appropriate to specific household financial conditions, credit experiences, preferences and demand of the disadvantaged sectors and non-bankable groups. It is also necessary that these are applicable within the local contexts that define the attributes of socially targeted beneficiaries and the poverty-stricken as well as isolated barangays in the rural areas.

Specifically, household financial conditions are characterized by the rural poor household that maintains adequate sources of income for the family. This includes the use of locally available resources to generate income and to satisfy daily basic needs. The average monthly cash flow

represents the ability of the household to meet survival requirements and to improve well-being of all its members. Since the household of the rural poor is also the locus of microentrepreneurial or income-generating activities, the household's financial conditions largely determine credit experiences. This also manifests the effort to meet their own credit needs by availing of the services offered by credit providers and moneylenders in the community.

Credit experience determines how the household is able to access locally available credit services as well as how credit is utilized for productive purposes, for consumption expenditure requirements and livelihood or microentrepreneurial investments. The extent and manner in which loan proceeds are utilized within the household is intricately linked to the borrower's repayment experience and ability to pay future loans.

The major actors in the credit experiences of poor households consist of credit providers, which include formal financial institutions (banks and lending investors); semi-

formal credit providers (credit-granting NGOs and credit associations) and the informal sector (moneylenders). Each type of credit provider employs different approaches in meeting the borrowers' credit needs and ultimately in responding to the overall financial conditions of the rural poor's household. Credit providers supply the necessary funds to borrowers on demand but the availability of their services is influenced by borrower's general credit-worthiness and agreed credit arrangements in the light of prevailing local socio-economic conditions.

Microcredit preferences and demand represent the beneficiaries' perception and attitude toward credit services especially when they are aware as to who provides the credit services. These could be gleaned from the amount of loan they want to borrow, the income-generating activities that need financing, the nature of assets they can provide as collateral to secure the loan, and the necessary support services needed to ensure productive use of loan funds, project profitability and the timeliness in paying back their loans.

While the enabling and limiting factors are crucial for planning and formulating microcredit program design, good governance is equally important in identifying and developing guidelines for implementation. These will help ensure that microcredit as a tool for poverty reduction is appropriate to local conditions as well as resources and acceptable based on needs and capabilities of program partners and target beneficiaries.

It is argued that the principles of good governance strengthen microcredit program and ensure successful operations. Participatory mechanisms help ensure that program design, implementation strategies encompassing the decision-making processes and transactions are appropriate to needs as well as capabilities and acceptable to program partners and target beneficiaries. Meanwhile, transparency helps ensure that adequate information about all program partners and target beneficiaries are easily accessible and well-disseminated, the decision-making processes are transparent and transactions are documented and readily available.

Accountability further ensures that roles, responsibilities, decisions and transactions are well-defined and administratively as well as legally enforceable based on contractual obligations. Finally, sustainability helps ensure the continued profitability of beneficiaries' income-generating projects and the long-term financial viability of the participating MFIs' microcredit operations. Ultimately, good governance ensures successful microcredit interventions for poverty reduction and rural development.

Most important to microcredit as a poverty alleviation tool is for the national and local government officials and the public service delivery system to create a favorable and comprehensive microcredit infrastructure that promotes collaboration among civil society and the business sectors either as sub-contractors for the delivery of complementary public services or financially viable credit-retailing MFIs themselves. Such a collaborative and innovative financial intermediation scheme will help ensure large-scale outreach to marginalized groups who are excluded from the mainstream commercial banking system and those who are

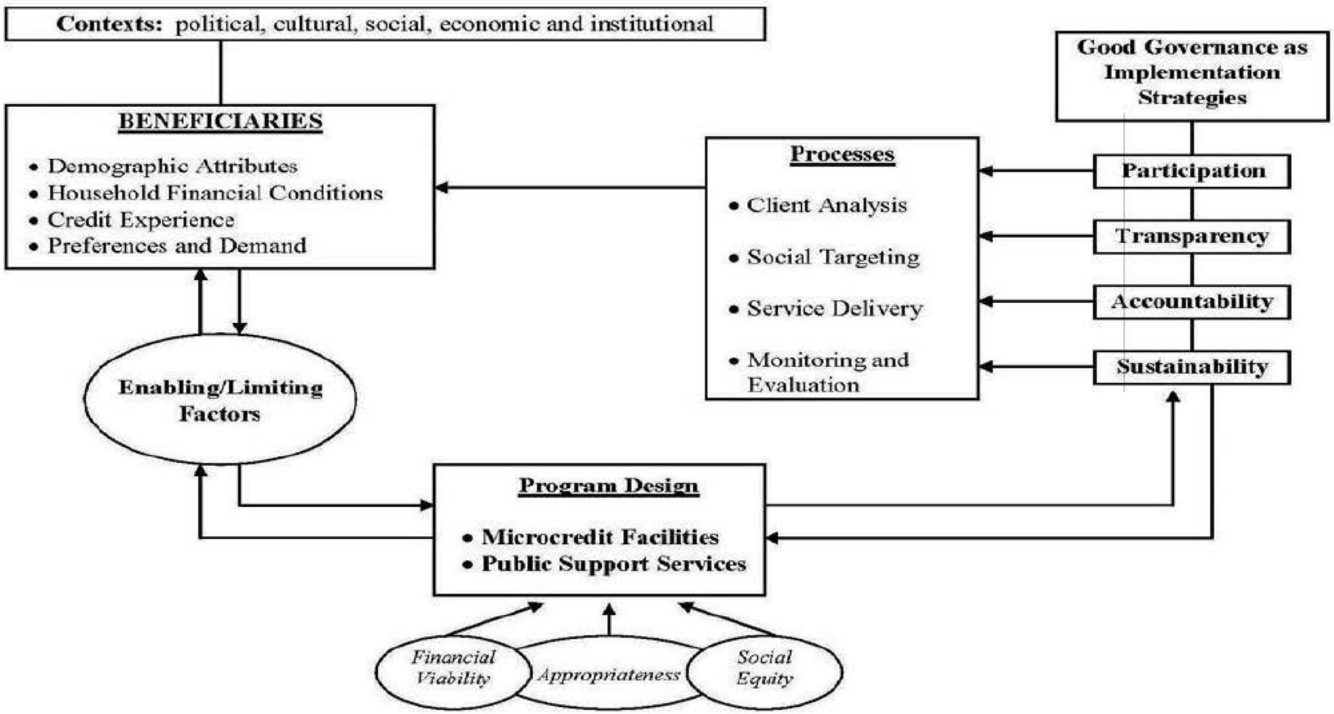
disconnected from municipal commercial and trading centers due to geographic remoteness or social distance.

The 1997 Microcredit Summit underscored that the key implications of microcredit is in its name itself: ‘micro'. A number of issues come to mind when 'micro' is considered: the small size of the loans made, small size of *savings* made, the frequency of loans, shorter repayment periods, the micro/local level activities, the community-based immediacy of microcredit, and other principles. Hence, microcredit is ***not the*** solution, but is a menu of options and enablements, that has to be put together, *a la carte*, based on local conditions, needs and capabilities.

Figure 3 shows the logical flow of the conceptual framework showing the household financial conditions as the primary factor for determining the prevailing credit situations of poor households in rural communities. Credit experience, credit needs, credit providers and microcredit preferences and demand are likewise central to the formulation of needs-based, client-responsive and appropriate microcredit

program design and other poverty reduction initiatives of the government. The output of the study comprises a set of implementation strategies and specific indicators which are appropriate to the prevailing local conditions and acceptable to all program partners, implementors and target beneficiaries.

Theoretical proposition showing the contextual factors and the interplay of socio-economic characteristics of target beneficiaries; the factors that enable or limit the program design, processes and implementation of microcredit facilities and public support services; and the application of good governance principles that are intended to attain desired outcomes.



9

CONCLUSION

Existing credit programs are designed only for those who are capable of meeting credit standards. The program designs are not intended for the poorest and most vulnerable sectors because they could not be readily helped by microcredit. The appropriate way of helping them is providing social safety nets, farm input subsidies and capability-building initiatives. These will enable them to satisfy basic needs and at the same time improve their credit-worthiness so that after a transition period, they will graduate into having regular access to microcredit program. These will further help them to finance their income-generating activities and ultimately increase their income.

Since commercial banking practices automatically exclude the poor and the vulnerable, the application and utilization of microcredit as a tool for poverty reduction becomes the primary responsibility of the government. Thus, microcredit becomes part of the Philippine government's poverty alleviation programs that is fully advocated and supported by the international donor community and implemented in collaboration with credit-

granting institutions from the civil society and business sectors.

The Grameen model is replicable through QUEDANCOR's microcredit program using SRTs. Meanwhile, BRAC's graduated model for helping the poorest and most vulnerable is replicable through the creation of a special poverty alleviation sub-component. Furthermore, the not-so-strong cooperatives wishing to start microcredit operations can be strengthened through CAP-PBD while qualified cooperatives can continue to access LBP's regular cooperative credit program and introduce microcredit into its existing lending operations. In this approach, the need for readily available support services from partner government agencies and NGOs is widely emphasized.

Furthermore, it is noted that there are factors that enable or limit the successful implementation of microcredit programs. The incorporation of enabling factors in program design will increase outreach towards beneficiaries, improve participation of other institutional stakeholders and facilitate

the attainment of program objectives and desired outcomes. On the other hand, the limiting factors will help in planning and carrying out strategies to manage, control and prevent the occurrence of circumstances that may adversely affect the attainment of targets and desired outcomes.

In implementing microcredit, an operative framework should be based on the principles of good governance. It should likewise encompass the larger and more comprehensive program for poverty alleviation and rural development. These are deemed necessary in formulating program design and implementation strategies for microcredit and special poverty alleviation initiatives.

The project cycle in the microfinancial intermediation infrastructure starts in the disbursement of wholesale credit funds from the foreign creditors and ends in the target beneficiaries' full loan repayment; which in turn forms a major part of the Philippine government's loan repayment to the foreign creditors. Thus, the good governance of microcredit program as a tool for poverty reduction

emphasizes the role of institutions in the microfinancial intermediation infrastructure.

The governance of microcredit programs for poverty reduction is further enshrined in the Philippine government's development thrusts and priorities along the lines of self-employment generation, food for the family, children's education and decent housing. The attainment of these goals through microcredit programs, however, emphasizes most heavily on institutional arrangements for the transfer of wholesale credit funds from the international donor community to retail microcredit facilities administered by credit-granting civil society organizations in the barangays and finally to individual borrowers.

Anchored on the principles of good governance for sustainable human development (participation, transparency, accountability and sustainability), this study contributes to the epistemology of public administration by providing research-based evidences that financial viability objectives are attainable in government-driven poverty

alleviation and rural development interventions. The findings are sufficient to encourage organized business sector actions in pro-poor microcredit programs in collaboration with the government and civil society organizations.

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